Implementation of State Auditor's Recommendations

Audits Released in 2000 and 2001

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INTRODUCTION

This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2000 through December 2001. The purpose of this report is to identify what actions, if any, these departments have taken in response to our findings and recommendations. We have placed this symbol ➲ in the left-hand margin of the department action to identify areas of concern or issues that we believe the department has not adequately addressed.

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

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

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of February 6, 2002.

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CALIFORNIA STATE UNIVERSITY

While Its System of Direct Vendor Payments Should Continue, Its Credit Card Program Could Benefit From Better Controls

REPORT NUMBER 96041, JULY 2000

Audit Highlights . . .

Our review of the California State University (CSU) revealed that direct payments to vendors were appropriate, properly supported, and documented. Accordingly, there is no need to return the payment process to the State Controller's Office.

Although we did not observe widespread abuse, our review of CSU's use of state-issued credit cards (PRO-Cards) also revealed that:

- ☑ *Not all purchases received review by an appropriate approving official.*
- ☑ *Some purchases violated policies and some purchases were questionable.*
- ☑ *Some purchases lacked sufficient supporting documentation.*
- ☑ *The CSU's chancellor's office and campuses could improve their own practices by learning about each other's best practices.*

A state law effective January 1, 1997, permits the California State University (CSU) to pay its vendors directly through December 31, 2001. Our review of the CSU's system found few problems, all of which were isolated rather than systemic. Consequently, we recommend that the Legislature allow CSU to pay its vendors directly beyond December 31, 2001.

Although we found few errors with payments made by check, we identified more problems with payments made by state-issued credit cards (PRO-Cards). CSU gives PRO-Cards to certain employees for official purchases to streamline the procurement process and to purchase low-value items economically. However, because of weak internal controls—a lack of clear policies and insufficient monitoring and enforcement—cardholders sometimes were able to use the credit cards to make questionable or improper purchases. Specifically:

Finding #1: We found few problems with the CSU's direct payments to vendors.

We found only 23 minor problems out of a possible 2,626 that we tested. These problems were scattered across six of the tested characteristics at five campuses and the chancellor's office. A previous review by the State Controller's Office (controller's office) had similar results and concluded that CSU's system of internal controls is generally adequate to ensure the legality and propriety of state disbursements. Further, according to the CSU's analysis supporting the change in the law, the CSU estimated that it would save $1.2 million annually by paying its vendors directly. Consequently, we concluded that returning the vendor payment process to the controller's office would be an inefficient use of state resources.

To ensure that the vendor payment system is efficiently administered, we recommended that the Legislature enact legislation that allows the CSU to continue to pay its vendors directly beyond December 31, 2001.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Finding #2: An appropriate approving official did not review all purchases.

The approving officials' level of review for card purchases varied greatly at the campuses we visited. Of the 1,205 purchases we reviewed, 97 (8 percent) lacked an approving official's signature on the monthly statement or had the incorrect signature. Statements missing the official's signature prompt us to question whether the purchases were properly reviewed, particularly because we were unable to verify that all employees signing in place of the approving official had received the same training on the proper use of the PRO-Card as the assigned official.

At least two campuses we visited did not ensure that approving officials held a supervisory or managerial position of a higher rank than cardholders, but rather allowed the cardholders' peers or subordinates to act as approving officials. Additionally, the Fullerton campus permits cardholders to purchase items for the official who subsequently approves the purchases even though the purchase could be viewed as questionable or inappropriate. Because there is little separation between the employee purchasing the item and the person reviewing the charges, employees may feel pressured to approve a superior's purchase instead of questioning its appropriateness.

To ensure that the proper officials consistently review all PRO-Card purchases and supporting documentation, the chancellor's office and each campus should take these actions:

- Design a clear approval process, taking into account the possibility that approving officials may be unavailable when monthly statements must be approved and forwarded for payment.

- Ensure that a cardholder's subordinate or peer is not designated as the approving official.

- Ensure that approving officials do not approve purchases made on their behalf, which could be viewed as personally benefiting them.

➲ ***CSU Action: Partial corrective action taken.***

The chancellor's office did not specifically address the approval process regarding approving officials being unavailable when monthly statements must be approved and forwarded for payment. The chancellor's office issued an executive order stating that a cardholder's subordinate or peer should not be responsible for the approval of credit card purchases; the order also directs approving officials not to approve their own purchases.

Finding #3: Someone other than the approved cardholder used some cards.

We found 31 uses of PRO-Cards by people other than the cardholder. Allowing such use is a serious breach of internal controls because it is unclear who would be accountable for any improper purchases made by these other users. Although we did not find improper purchases, it is possible that improper purchases could be made.

To ensure that only authorized employees purchase items on the PRO-Card, we recommended that the chancellor's office and each campus prohibit the use of PRO-Cards by anyone other than the cardholder.

CSU Action: Partial corrective action taken.

The chancellor's office stated that all campuses have been directed to ensure that strong internal controls are in place to prevent abuse or excess liability through use of PRO-Cards. However, the chancellor's office did not indicate if any campus had procedures in place to prevent misuse of PRO-Cards.

Finding #4: The chancellor's office issued PRO-Cards to non-state employees.

The CSU did not adhere to the guidelines in its contract with the bank that issues the PRO-Card. It states that the PRO-Card program is intended for university employees only. However, we found that the chancellor's office provides PRO-Cards to employees of the California State Student Association (CSSA), a nonprofit organization representing CSU students. Use of the PRO-Card by CSSA employees also raises the question of whether it is appropriate for

non-state employees to use state resources. Use of the PRO-Card by CSSA employees requires that CSU employees who administer the PRO-Card program spend time reviewing and paying the charges. Moreover, the CSU may not be protected from liability issues with regard to CSSA employees because non-state employees are not covered in the contract between CSU and the bank that issues the credit cards.

To prevent non-state employees from abusing state resources and creating a liability, we recommended that the chancellor's office and each campus ensure that only state employees can receive PRO-Cards.

➲ ***CSU Action: None.***

In August 2001 the chancellor's office reported that a CSSA employee had misused a PRO-Card in April 2000. The chancellor's office estimated that the misuse amounted to $10,000. Ultimately, CSSA dismissed this employee. However, the chancellor's office indicated that rather than recovering PRO-Cards from all non-state employees, it will require that use of PRO-Cards by CSSA employees will be reviewed and approved by a chancellor's office employee.

Finding #5: Some purchases violated policies while others were questionable.

Overall, we did not identify widespread personal abuses. However, some purchases made with the PRO-Card violated individual campus policies, other purchases appeared unreasonable or inappropriate, and still other purchases appeared personal or did not further the CSU's educational mission. In some cases, officials approved payment of charges even though it was obvious that employees were circumventing campus policies that limit their charges. Of 1,205 PRO-Card purchases at the chancellor's office and 12 campuses, we found 165 with these problems out of a possible 3,615 (4.6 percent). While 6 campuses had very few problems, we found numerous exceptions at the chancellor's office and 6 remaining campuses. Some purchases had more than one problem.

We also found questionable purchases that campus PRO-Card policies did not specifically address. For example, employees at the chancellor's office, and the campuses of Hayward, Long Beach, Monterey Bay, Sacramento, and Stanislaus used PRO-Cards to purchase $1,027 worth of flowers and plants for new employees

and for other employees to offer sympathy, thanks, congratulations, and get-well wishes. These purchases are not items for which a state agency would normally pay; public dollars should not be spent for gifts. CSU employees should purchase gifts for co-workers with their own money.

Purchases of snacks, refreshments, and meals for staff meetings, training sessions, and lunches are also questionable. We found three occasions when the chancellor's office purchased coffee and kitchen supplies for its employees. We also noted numerous instances when Fullerton campus employees purchased refreshments for their meetings with their PRO-Cards. The cardholders did not reimburse the CSU for these purchases.

To ensure that personal or inappropriate items are not purchased with PRO-Cards, we recommended that the chancellor's office and each campus expressly prohibit purchases—such as alcohol, food, flowers, gifts, or other items—that could be used for personal benefit, unless the purchase is preapproved and the cardholder demonstrates that the purchase meets the university's mission. Food purchases for CSU employees do not meet the mission of the university unless one of the following circumstances exists:

- Official university business is being conducted with individuals who are not CSU employees.
- All CSU employees present are on travel status.
- The food is purchased for events, such as training, where some CSU employees present are on travel status.

CSU Action: Partial corrective action taken.

The chancellor's office stated that each campus is required to develop written policy and procedures to implement the chancellor's office executive order "Hospitality, Payment, or Reimbursement of Expenses." Further, the chancellor's office stated that the use of the PRO-Card for purchase or payment of meals or other items that could be construed to be of personal benefit is subject to preapproval by an authorizing official. However, the chancellor's office did not indicate if the campuses ensure that their policies and procedures are followed by employees using the PRO-Card and if employees reviewing and approving PRO-Card purchases enforce the policies.

Finding #6: Some PRO-Card purchases lacked sufficient supporting documentation.

Insufficient documentation prevented us from determining whether a number of the purchases we reviewed were appropriate. This was true for 160 (13 percent) of the 1,205 PRO-Card purchases we reviewed. Some may have been appropriate; others may not have been business-related or in compliance with campus policy. For example, many purchases lacking documentation were for meals. If cardholders do not provide a meeting agenda, state the purpose of the meeting, and who attended, neither we nor any other independent reviewer, including the approving official, can ensure that the meal has a legitimate business purpose.

We also found that some purchases lacked detailed receipts. For instance, documentation for 134 purchases either did not include itemized or detailed receipts, or had no receipt at all.

So that reviewing officials can determine the appropriateness of purchases, we recommended that the chancellor's office and each campus do the following:

- Require that cardholders sufficiently describe the purpose for each purchase.

- Require, as necessary, an authorization form prior to the purchase, for example, for sensitive items such as food purchases. For food items, this form should include the meeting agenda, the purpose of the meeting, a list of attendees, and an explanation of how the purchase meets CSU's mission and goals.

- Insist that cardholders include itemized receipts with their monthly PRO-Card statements and annotate receipts lacking sufficient descriptions of purchases.

CSU Action: Partial corrective action taken.

The chancellor's office stated that prohibited items and card usage is emphasized in training sessions for new users, however, it did not specify whether such training occurred at any campus.

Finding #7: The chancellor's office and most campuses do not reconcile travel-related charges to travel expense claims.

PRO-Card policies at all campuses except Fullerton prohibit the charging of travel-related expenses to the PRO-Card. Despite these policies, in some instances, employees were allowed to charge

travel-related costs. However, with the exception of the Fullerton campus, which not only allows but also encourages employees to use PRO-Cards for travel expenses, the chancellor's office and many campuses do not reconcile travel-related expenses charged to the PRO-Card with the travel expense claims used to reimburse employees. For example, many campuses allow fees for out-of-town conferences to be charged to the PRO-Card. Because employees may also list these fees on their travel expense claims as a business expense, the fees could be paid twice if campuses do not reconcile travel expense claims to PRO-Card statements.

To avoid duplicate payments, we recommended that the chancellor's office and each campus reconcile all travel-related expenses charged to the PRO-Card with employees' travel expense claims.

CSU Action: Partial corrective action taken.

The chancellor's office stated that campuses that allow usage of the PRO-Card for travel have established internal controls to prevent duplicate payments. Although the chancellor's office reported that prohibited items and card usage is emphasized in training sessions for new users, it did not specify whether such training has occurred at any campus.

Finding #8: Many employees violate PRO-Card policies without suffering consequences.

We found that the campuses inconsistently reprimand employees who repeatedly violate PRO-Card policies, for example, by providing insufficient documentation for purchases. Another shortcoming identified in PRO-Card transactions is the failure of many campuses to identify inappropriate purchases and ensure that staff or faculty reimburse the campus for personal purchases. Unless personal charges and related reimbursements are monitored, the CSU may not recover all funds due from cardholders.

To ensure that employees follow PRO-Card policies, officials take appropriate action for questionable or improper purchases, and, when necessary, employees reimburse CSU for inappropriate PRO-Card charges, we recommended that the chancellor's office and each campus take the following steps:

- Track policy violations, including personal charges, and suspend or cancel cards when necessary.

- Monitor inappropriate charges and subsequent cardholder reimbursements.

- Create a review process to ensure that cardholders and approving officials comply with PRO-Card policies.

CSU Action: Partial corrective action taken.

The chancellor's office stated that all campuses have been directed to establish internal policies and controls consistent with the above recommendations and CSU policy. The chancellor's office also stated that it implemented a program to monitor and enforce PRO-Card usage policies by tracking violations. Further, the chancellor's office stated that it has shared a user handbook with all campuses and assisted campuses with program implementation.

However, the chancellor's office did not specify which campuses had implemented similar monitoring programs.

Finding #9: Some campuses have stronger internal controls over PRO-Card use than others.

The chancellor's office and campuses could learn and benefit from each other's best practices. Some of the policies and procedures governing the use of PRO-Cards are more effective than others at controlling PRO-Card purchases. Not every campus has an adequate system to monitor cardholders. Finally, although every campus we visited told us that it threatens cardholders who do not adhere to policies with warnings, a reduced credit limit, and finally, confiscation of the card, not all of the campuses follow through with the prescribed action. Unless the campuses and the chancellor's office carry out cardholder reprimands, problems will continue to exist within the program.

To improve the overall quality and consistency of internal controls over PRO-Card use, we recommended that the chancellor's office and each campus review and consider implementing each other's best practices.

CSU Action: Partial corrective action taken.

The chancellor's office stated that best practices related to the PRO-Card program practices have frequently been addressed at both system-wide and national higher education buyer meetings.

The chancellor's office did not indicate whether any campuses have implemented best practices addressed in meetings.

CALIFORNIA COMMUNITY COLLEGES

Poor Oversight by the Chancellor's Office Allows Districts to Incorrectly Report Their Level of Spending on Instructor Salaries

REPORT NUMBER 2000-103, OCTOBER 2000

Audit Highlights . . .

Our review found that:

- ☑ *Six of 10 districts did not meet the 50 percent threshold for spending on instructor salaries despite having reported compliance with the law.*
- ☑ *Board of Governors' regulations allowing districts to exclude costs for certain ancillary services not explicitly stated in the law do not further the Legislature's goal of providing more funding for instructional programs.*
- ☑ *Chancellor's Office training and monitoring is weak and does not provide adequate guidance or identify district misreporting. It also does not monitor the CPAs on whom it primarily relies to verify whether district reports are accurate.*

The Joint Legislative Audit Committee (audit committee) requested that we review how the Chancellor's Office of the California Community Colleges (Chancellor's Office) implements the law requiring community college districts (districts) to spend 50 percent of their current educational expenses on salaries of instructors. The audit committee wanted to learn whether the Chancellor's Office appropriately instructs districts on calculating compliance with the law, commonly known as the 50 percent law. We found that:

Finding #1: Districts overstate their compliance rates.

Six of 10 districts we visited did not meet the 50 percent requirement for fiscal year 1998–99, despite reporting compliance with the law in annual reports to the Chancellor's Office. They overstated their compliance rates by inappropriately including administrative salaries and benefits in instructor salaries, and excluding from current educational expenses normal operating expenses or district-funded expenditures for categorical programs.

We recommended that the Chancellor's Office clarify its instructions to the districts and provide districts with regular training on compliance with the 50 percent law.

Chancellor's Office Action: Partial corrective action taken.

The Chancellor's Office reports that it presented changes in 50 percent law compliance tests to CPAs and district staff in May 2001 workshops. It says that it also reviewed input from the audited community college districts and work papers of the Bureau of State Audits to better define what clarifications in instructions were needed.

The Chancellor's Office states that it has pursued various alternatives for providing training to district staff. Such alternatives include, but are not limited to, making presentations for chief business officials. It also says that on October 1, 2001, it filled a new position to perform fiscal reviews and offer technical assistance.

Finding #2: Regulations adopted by the board of governors allow districts to incorrectly reduce current educational expenses.

The board of governors has adopted regulations allowing districts to exclude costs for all ancillary activities including bookstore, child development, parking, and student housing operations. The law, however, specifically describes only three such activities as excludable—student transportation, food services, and community services—and does not include a catchall category for "other" similar activities. Including General Fund expenditures and transfers to subsidize noninstructional activities, such as bookstore, child development, parking, and student housing as part of a district's current educational expenses, furthers the legislative goal of providing more funding for instructional programs.

We recommended that the Chancellor's Office discontinue its practice of excluding from the compliance calculation noninstructional activities not enumerated in the law or seek an opinion from the attorney general to support its interpretation of the law as reflected in the regulations.

➲ ***Chancellor's Office Action: None.***

The Chancellor's Office states that it respectfully disagrees with our recommendation, but is still studying the practical effects of ancillary programs in the districts.

Finding #3: Ineffective oversight by the Chancellor's Office allows districts to misreport their compliance rates.

The Chancellor's Office relies primarily on district-hired CPAs to ensure that districts' reports are accurate, but because these CPAs use inadequate audit procedures developed by the Chancellor's Office, they fail to discover errors. Also, some CPAs even fail to demonstrate that they have completed the audit procedures from the Chancellor's Office. Since fiscal year 1993–94, the Chancellor's Office has not routinely inspected the CPAs work to ensure that districts are complying with the 50 percent law.

We recommended that the Chancellor's Office expand suggested audit procedures for district CPAs to detect errors in risky areas, such as faculty reassignments and exclusions from current educational expenses. We also recommended that the Chancellor's Office perform routine, independent checks of work CPAs do for the districts.

Chancellor's Office Action: Partial corrective action taken.

The Chancellor's Office reports that it presented changes in 50 percent law compliance tests to CPAs and district staff in May 2001 workshops. It also says that it has resumed, to the degree possible, CPA work paper reviews. The Chancellor's Office currently has one new position being funded by the Governor for fiscal accountability. That position was filled and the staff started work on October 1, 2001. Further, the Chancellor's Office says it will establish a formal policy to address instances when it finds that CPAs audit work is substandard.

CALIFORNIA COMMUNITY COLLEGES

The Chancellor's Office Should Exercise Greater Oversight of the Use of Instructional Service Agreements for Training or Services

REPORT NUMBER 96040, JANUARY 2000

Audit Highlights . . .

Our review of California's community college districts (districts) revealed that the Chancellor's Office:

- ☑ *Is not properly monitoring the districts' use of instructional service agreements.*
- ☑ *Does not have the information needed to determine which districts have instructional service agreements.*
- ☑ *Revised its district audit manual but the manual is still incomplete.*

In accordance with Chapter 690, Statutes of 1997, we reviewed California's community college districts' (districts) compliance with regulations prohibiting the districts from receiving apportionment funding for activities that are fully funded through another source. Districts use the apportionment funds they receive to support their community colleges, including the instruction provided. Districts can use instructional service agreements (ISAs) to contract with public or private entities to provide specific training or services. This report concludes that the Chancellor's Office has been slow to review and follow-up on the district's compliance with regulations concerning ISAs. Specifically, we found:

Finding #1: The Chancellor's Office is not properly monitoring the districts' use of ISAs.

The Chancellor's Office has been slow to monitor and follow up on district annual audits performed by local independent certified public accountants (CPA). These CPA reports include information on the districts' compliance with regulations concerning ISAs. As of December 1999, the Chancellor's Office had reviewed only 18 of the 71 reports it had received 11 months earlier. Since it has not yet reviewed all 71 audit reports, the Chancellor's Office has only limited assurance that it properly allocated funding to the districts.

We recommended that the Chancellor's Office review district audit reports to ensure that CPAs have performed the required audit procedures to assess district compliance with state regulations on ISAs and promptly follow up on any state compliance issues identified in these annual audits.

Chancellor's Office Action: Corrective action taken.

The Chancellor's Office has completed the recommended action and has received and reviewed all 71 audit reports for fiscal year 1998–99.

Finding #2: The Chancellor's Office may have provided state apportionment funds for full-time equivalent students (FTES) that did not comply with existing Chancellor's Office regulations.

For fiscal year 1997–98, Barstow and Lassen community college districts received state apportionment funding for FTES generated through ISAs using instructors that did not have signed contracts with their districts. Such FTES do not comply with Chancellor's Office regulations and therefore would not qualify for apportionment funding. In addition, Chabot-Las Positas Community College District received state apportionment funding for FTES claimed through an arrangement with the sheriff's academy without having an ISA with that agency. Chancellor's Office regulations do not allow FTES to be generated in that manner.

We recommended that the Chancellor's Office determine whether the FTES credits Barstow and Lassen community college districts generated through their respective ISAs complied with State Education Code and the Board of Governors' regulations. We also recommended that the Chancellor's Office determine whether the FTES credits generated by Chabot-Las Positas Community College District met the requirements for state apportionment.

Chancellor's Office Action: Corrective action taken.

A specialist in vocational education with responsibility for ISAs has reviewed both districts and informed the Chancellor's Office that both are in compliance.

Finding #3: The Chancellor's Office lacks information to determine which districts have ISAs.

When we asked if the Chancellor's Office could provide us with the number of FTES individual districts generate from ISAs, we were told such information is not available at the Chancellor's Office. Without knowing which districts generate FTES through ISAs, the Chancellor's Office cannot assess which districts may be more likely to receive state apportionment funding based on agreements that do not comply with the requirements outlined in the district audit manual or the contract guide.

We recommended that the Chancellor's Office require districts to submit a list of their ISAs and the number of FTES the districts estimate they will generate through such agreements. The Chancellor's Office should utilize this information in its review and follow-up of the districts' annual audit reports to better assure that districts are entitled to the apportionment funding.

Chancellor's Office Action: Partial corrective action taken.

The Chancellor's Office is now gathering information regarding FTES generated at each community college by ISAs through the automated reporting system currently in place.

Finding #4: The Chancellor's Office's district audit manual is incomplete.

Although the Chancellor's Office revised its district audit manual to require the CPAs to test ISAs, its suggested audit procedures do not include such items as verifying that contracting entities certify that the direct education costs of their classes are not being fully funded through other sources. Such a certification is required by Section 58051.5 of Title 5 of the California Code of Regulations. Because it did not include this provision in its Contracted District Audit Manual, the Chancellor's Office has less assurance that districts comply with its provisions.

We recommended that the Chancellor's Office revise its Contracted District Audit Manual to require CPAs to specifically test the districts' compliance with regulations that prohibit them from claiming FTES for fully funded classes.

Chancellor's Office Action: Corrective action taken.

The Chancellor's Office has amended its Contracted District Audit Manual to require district auditors to specifically test the districts' compliance with regulations that prohibit them from claiming FTES for classes fully funded through another source.

LOS ANGELES COMMUNITY COLLEGE DISTRICT

It Has Improved Its Procedures for Selecting College Presidents

REPORT NUMBER 99134, AUGUST 2000

Audit Highlights . . .

Our audit of the procedures used by the Los Angeles Community College District (district) to select its college presidents disclosed that:

- ☑ *In the past, the district followed selection procedures that were generally consistent with each other and allowed for involvement by the college community.*
- ☑ *Its revised procedures improve the accountability of the process, provide for greater community involvement, and are similar to those of other community college districts.*
- ☑ *The district has been slow to replace interim presidents. In four instances since 1995, the district has had an interim president at a college longer than state regulations permit.*
- ☑ *District costs to select college presidents have increased significantly, but are not out of line with costs other districts have incurred.*

At the request of the Joint Legislative Audit Committee, we audited the process the Los Angeles Community College District (district) uses for selecting the presidents for its nine campuses. This report concluded that, although the district followed its Board of Trustees (board) selection procedures, the district did not always hire presidents. In 1999 the district's board rejected the list of finalists forwarded to it by the search committees at Mission and Harbor Colleges and chose instead to appoint interim presidents. The district subsequently revised its selection procedures to increase quality controls and community involvement and conducted new searches that resulted in appointments of presidents at these colleges in 2000. Although the revised procedures are similar to those we identified as "recommended practices" and to those used by some of the 18 California community college districts we surveyed, we found several conditions relating to the selection of college presidents that can be improved. We also concluded that the district's costs to conduct a search process are not out of line with those of other districts.

Finding #1: The district's revised procedures do not explicitly include some recommended practices.

The district's new selection procedures for hiring college presidents, revised in September 1999, improved the accountability of the process by designating a person responsible for ensuring compliance with board procedures and by establishing timelines for the selection process. The new procedures also provided for greater community involvement by, for example, having a greater proportion of representatives appointed from the campus community with fewer board and district appointees on the selection committee. These procedures are similar to those used by some of the 18 California community college districts we surveyed and to those recently developed by the Community College League of

California (league), a nonprofit corporation whose voluntary membership consists of the 72 local community college districts in California.

The district should consider adopting those league-recommended practices that it is not currently using, such as establishing a budget for each search.

District Action: Corrective action taken.

In its one-year response to us dated September 14, 2001, the district stated that it had reviewed the league-recommended practices and while it had considered a number of ideas, the district stated that it generally follows the recommendations.

Finding #2: Although the district encourages open meetings on campus to present the candidates to college employees, students, and residents of the community, open meetings are not always held.

While not requiring such meetings, the district's procedures suggested that these are good opportunities for the committee members to assess how well the candidates and college community would work together and how effectively the candidates would deal with specific concerns at the college. The committee for the recent Harbor College search chose not to have an open meeting. We believe open meetings on campus are an important quality control, as well as an opportunity for more community involvement.

The district should consider making open meetings on campus a standard practice unless the search committee has compelling reasons why such meetings should not be held.

District Action: Corrective action taken.

On August 23, 2000, the board modified its rules to require open meetings to be held for the purpose of presenting presidential finalists to district residents and college faculty, staff, and students. Feedback from these meetings is provided to the board prior to its final hiring decision.

Finding #3: The district's contract with its search consultant does not clearly specify the tasks to which the district and the consultant agreed.

Although the district opted to use a search consultant in the Mission and Harbor College searches completed in 2000, the contract between the district and its consultant was not entirely clear about the specific tasks to which the district and the consultant agreed. In one example, the contract called for the consultant to communicate with the board, but it did not specify the form or frequency of the communication. In fact, we found no written progress reports from the consultant. Although we have no indication of conflict between the district and the consultant over these contract provisions, more precise descriptions of deliverables in the future could forestall potential problems.

The district should ensure that contracts with search consultants include a detailed statement of work and consider including a requirement for consultants to provide periodic written status reports to either the chancellor or the board so the district may gauge their progress and value.

District Action: Corrective action taken.

The district indicated that its request for proposals distributed recently to potential search firms contains a detailed statement of the work of the consultant, and it calls for written status reports to be presented periodically to the chancellor or board. The district stated that these reports are now routinely submitted to the board in its closed sessions.

Finding #4: The district needs to improve its record keeping for its search activities.

We found no evidence suggesting that candidates had been evaluated unfairly in the recent Mission and Harbor College searches. However, the search committee did not always appropriately document its evaluation process. In some instances, we were unable to determine what criteria the committee used to evaluate candidates it had interviewed. Although we saw interview questions, district staff responsible for the conduct of the process could not provide us with any summary of interview evaluations or evidence of whether the finalists were selected by the committee solely based on the interview questions or if other criteria were used.

We believe that the tasks a selection committee undertakes are not only important to ensure that the most qualified individuals are selected as finalists, but also to demonstrate that the process was conducted in a fair and equitable manner. When there is an incomplete record of some of the procedures used in the selection process, the district may not be able to assure critics of the process that the selection was carried out in an appropriate manner.

We recommended that the district archive search documents to demonstrate the district's compliance with all required procedures and to memorialize the process for subsequent searches.

District Action: Corrective action taken.

The district reports that it is archiving the records of recent presidential searches, and holding records of currently active searches, to ensure the information is available for future review.

Finding #5: In the last five years, the district has had four interim presidents whose appointments exceeded the one-year limit.

According to a provision in the California Code of Regulations, no interim appointment of a president may exceed one year in duration. This provision is designed to protect colleges against interim presidents who may prefer to assume caretaker, rather than leadership, roles, and who may be reluctant to make long-term decisions. In addition, if the board appoints an interim president without receiving community input, actions taken by the interim president may have less community support.

Although the regulations allow the California Community College Chancellor (state chancellor) to approve an extension of up to one year for interim appointments if a district demonstrates a pressing business need, the district has not submitted any requests for extensions during the last five years. According to data provided to us by the district, Mission and Pierce Colleges had interim presidents for 25 months and 27 months, respectively, and Harbor College had an interim president for 18 months. The current president of Southwest College is also an interim president, a position she has been filling since August 1996.

The district should perform selection procedures promptly to avoid having interim presidents serve longer than the California Code of Regulations allows. If the district cannot meet this timeline, it should request a waiver from the state chancellor, demonstrating

that it has a pressing business need to continue operating with an interim president. We also recommended that the district develop procedures for selecting interim presidents and submit them to the board for approval. Also, the district should consider whether appointing an interim president who may apply for the position is appropriate.

District Action: Partial corrective action taken.

The district reports that it intends to perform selection procedures promptly to avoid having interim presidents serve longer than the California Code of Regulations allows. In cases where longer service by an interim president is required, the district plans to seek the appropriate waiver, indicating the business need for the arrangement. Regarding the selection of interim presidents, the district believes its interests are best served if it retains the flexibility to devise selection procedures that conform to applicable circumstances as they arise, and refrains from adopting a fixed procedure. The board also articulated its position on the issue of appointing interim presidents who may later become applicants for the regular position. Whenever the board appoints an interim president it will make a determination on the matter based on the totality of the circumstances existing at the time. In its one-year response to us dated September 14, 2001, the district stated that it had used open selection processes, which are similar to the regular presidential selection process, to hire interim presidents.

Finding #6: The district does not have a system to track the costs associated with the search for each of its college presidents.

Although the district was able to provide certain cost information upon our request, it generally does not have a system to track costs associated with each search. The district's costs of selecting a president have risen significantly in the last year, from an average of $6,200 for the searches ended in 1999 at Harbor, Pierce, and Mission Colleges, to $32,000 or more for the searches completed in 2000 at Harbor and Mission Colleges. The Harbor and Mission Colleges searches, which were repeated because of the district's failure to appoint presidents in 1999, were more expensive in 2000 largely as the result of increased travel expenses for candidates and the district's decision to hire a search consultant. However, although the district's search costs increased, its expenses were still comparable to those of other districts performing similar searches.

The district should develop a system to separately track all costs associated with each presidential search. This will allow the district to determine if costs are reasonable and to budget appropriately for future searches.

District Action: Partial corrective action taken.

In its one-year response to us dated September 14, 2001, the district stated that it plans to implement a major upgrade of its accounting system within the next year or two and anticipates that its ability to track the costs of presidential searches will improve greatly. In the meantime, the district is implementing a method of identifying expenses related to individual searches using a simple spreadsheet approach.

DEPARTMENT OF CONSUMER AFFAIRS

Lengthy Delays and Poor Monitoring Weaken Consumer Protection

REPORT NUMBER 2000-111, NOVEMBER 2000

The Joint Legislative Audit Committee requested that we determine whether the Department of Consumer Affairs (department) is properly overseeing its boards and bureaus and to assess board and bureau regulatory operations. We found that the department has not provided adequate oversight to its boards and bureaus, and as a result, has allowed weaknesses in their regulatory functions to continue.

Audit Highlights . . .

Our review of the Department of Consumer Affairs (department) disclosed that:

- ☑ ***The department has not fulfilled its oversight responsibility over its boards and bureaus, allowing weaknesses in licensing and complaint processing to continue undetected.***
- ☑ ***The department diverted its internal audit resources away from reviews of the licensing and complaint processes of its boards and bureaus, using them instead on lower-risk special projects.***
- ☑ ***Many boards and bureaus do not publicly disclose complaint information even though department policy requires such disclosures.***
- ☑ ***None of the four boards and bureaus we visited is promptly processing all complaints.***

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Finding #1: The department had diverted its internal audit resources away from reviewing the licensing and complaint processes of its boards and bureaus and instead used them on lower risk special projects.

The department's oversight efforts have relied heavily on unverified information reported by the boards and bureaus themselves, such as strategic plans, regulations, annual statistical reports, and any results from the periodic Joint Legislative Sunset Review Committee process. This self-reported information, while useful, should not be the department's exclusive source of assurance that the boards and bureaus are protecting consumers.

We recommended that the department establish a plan to periodically review and evaluate the licensing and enforcement functions of its boards and bureaus. Additionally, we recommended that the department better utilize the resources of its internal audit office to consistently review the boards and bureaus to ensure that they have adequate monitoring systems and established processing goals.

Department Action: Corrective action taken.

The department reported it has hired additional staff for its internal audit office and has established an audit committee to guide the activities of its internal audit office. The department also reported that since January 2001, the internal audit office commenced 4 licensing and enforcement audits, and completed 12 internal control audits and two performance audits of its boards and bureaus. Furthermore, the department

- ☑ *Nineteen of the 35 boards and bureaus we reviewed or surveyed had not established time goals they could use as a way to monitor their effectiveness in responding to complaints.*
- ☑ *The Bureau for Private Postsecondary and Vocational Education temporarily discontinued investigating some complaints including allegations of serious violations of law.*
- ☑ *Disciplinary cases requiring legal representation by the Attorney General's Office frequently take more than a year to resolve.*

stated that its fiscal year 2001–02 audit plan dedicates 50 percent of its audit resources to performing audits at selected boards and bureaus.

Finding #2: Boards and bureaus do not consistently comply with the department's complaint-disclosure policy.

Department policy requires boards and bureaus to publicly disclose complaints that are determined to involve probable violations of licensing laws and regulations, such as warning letters, citations, and license suspensions or revocations. However, 19 of the boards and bureaus we surveyed indicated that they do not publicly disclose complaints that result in warning letters. When boards and bureaus do not disclose complaint information in conformity to the department's policy, consumers are deprived of information they need to make informed decisions.

We recommended that the department ensure that its boards and bureaus are consistent in releasing complaint information to the public.

Department Action: Partial corrective action taken.

The department reported that it is drafting a new complaint disclosure policy, and has held two public hearings at different locations within the State to solicit proposed language for the revised policy. Two more public hearings are scheduled to provide additional public participation. The department has also collected data from the boards regarding the point at which they release complaint information to the public, and has encouraged boards to have a current and accessible disclosure policy.

Finding #3: The Bureau for Private Postsecondary and Vocational Education (BPPVE) has deficiencies in its licensing and complaint processes.

Because the BPPVE provides inadequate guidance to its staff and does not adequately monitor its licensing and complaint processes, it cannot ensure that consumers are well protected from the institutions it regulates. Additionally, the BPPVE temporarily discontinued investigating complaints that it was unable to mediate, and overcharged institutions for license fees.

We recommended that the BPPVE:

- Establish a system to monitor its licensing and complaint processes to ensure they are prompt and effective.
- Develop policies and procedures to guide staff in consistently and effectively carrying out its regulatory activities.
- Ensure that it investigates all consumer complaints, especially those it cannot mediate.
- Continue its efforts to identify and reimburse those institutions that were overcharged for licensing fees.

BPPVE Action: Corrective action taken.

The BPPVE reported it has developed a monitoring system to ensure that its licensing and complaint activities are prompt and effective and developed policies and procedures to guide its licensing and enforcement staff. The BPPVE also reestablished its relationship with the department's division of investigations to handle complaints that it cannot mediate, and is continuing its efforts to identify institutions that were overcharged license fees.

Finding #4: The Dental Board of California (board) does not adequately monitor its licensing and complaint processes, has not established timelines for the prompt resolution of complaints, and has several weaknesses in its internal controls over cash receipts.

We recommended that the board develop a system to monitor its licensing and complaint processes and develop time goals for resolving complaints. We also recommended that the board identify causes of delays in resolving consumer complaints and take action to minimize them. Finally, we recommended that the board strengthen its controls over cash receipts.

Board Action: Corrective action taken.

The board reported it has established time standards for the processing of complaints. It has also developed a manual monitoring system to assess how quickly it processes licenses and complaints. The board is continuing to address the causes of delays in its complaint processing by hiring an additional dental consultant and seven more investigators. Finally, the board stated that it had instituted several control processes to better safeguard cash receipts.

Finding #5: The Bureau of Automotive Repair's (bureau) licensing operation, handled by the department prior to July 2000 when the bureau assumed control, has a flaw in its tracking system that caused some significant delays. Additionally, complaints received for the bureau's auto repair consumer protection program are taking too long to resolve.

We recommended that the bureau develop a system to monitor its licensing activities for promptness and to take actions to improve the time it takes to respond to consumer complaints.

Bureau Action: Corrective action taken.

The bureau reported it has developed a system to monitor all license applications to ensure that they are processed promptly. The bureau also stated that it has developed new computer programs and hired additional staff that will assist it in resolving consumer complaints more rapidly.

Finding #6: The Contractors State License Board (CSLB) has experienced delays in processing consumer complaints as a result of its reengineering efforts.

We recommended that the CSLB continue to monitor the results of its reengineered complaint-handling process to ensure that it responds promptly to consumer complaints and that consumers have adequate access to its services.

CSLB Action: Corrective action taken.

The CSLB stated it would continue to monitor its complaint process to ensure that it promptly responds to consumer complaints and that consumers have adequate access to its services.

Finding #7: Disciplinary cases requiring legal action through the Attorney General's Office (AGO) experience long delays, with some taking up to three years to resolve. However, because neither the AGO nor the boards and bureaus track the causes for delay, we were not able to identify why these cases take so long to resolve.

We recommended that the department, the AGO, and the various boards and bureaus within the department should review the data compiled by the AGO's new management reporting system as a means to identify and resolve delays. If this effort is unsuccessful, the department should recommend to the Legislature an alternative to the current system of AGO representation.

Department Action: Pending.

The AGO is still in the process of implementing its new management time reporting system. It has encountered technical problems in its implementation of the system and now expects the system to be fully operational by June 2002.

CALIFORNIA STATE PRISON, SAN QUENTIN

Investigations of Improper Activities by State Employees, Report I2000-2

ALLEGATIONS I990090, AUGUST 2000

While employed at the California State Prison, San Quentin (prison), an employee improperly established a museum on prison grounds and, as an officer of a nonprofit organization (association), used more than $1,300 of the association's funds for personal benefit, and paid wages to the association's employees without withholding required taxes.

Audit Highlights . . .

An employee engaged in the following improper governmental activities:

- ☑ *Made improper representations to other governmental entities when establishing a nonprofit organization (association) affiliated with California State Prison, San Quentin.*
- ☑ *Used more than $1,300 of the association's funds for personal purposes and made other questionable expenditures from the association's account.*
- ☑ *Failed to withhold payroll taxes and make payments to tax authorities for employees of the association's museum.*

Finding #1: An employee misrepresented the prison's role in the management of the association.

Specifically, the employee led the secretary of state, the Internal Revenue Service, and the Franchise Tax Board to believe that the prison's warden would oversee the association and its museum. He made these representations when filing documents with those entities to establish the association as a nonprofit public benefit corporation, thereby implying that the State and the prison accepted responsibility for the association. However, the employee never told the wardens that they were named as having responsibilities related to the association. Instead, through casual remarks to them, he led them to believe they had no such responsibilities.

Finding #2: Contrary to state law and the association's articles of incorporation, the employee spent $1,338 of the association's cash for his own benefit from April 1998 through January 1999.

In addition, the employee inappropriately wrote at least three checks totaling $1,300 on the association's account for parties. The employee claimed that he inadvertently used the association's funds for his personal benefit and, in mitigation, he made donations to the association that total more than the amount of funds he used. Although the employee made approximately $3,265 in donations to the association, it was improper for him to use the association's funds as he did.

Finding #3: The employee paid association wages to at least five employees of the museum from 1995 through 1998, but did not withhold required taxes or remit them to the Employment Development Department as required.

The employee told us he considered the employees to be independent contractors rather than employees. The wardens in charge at the time told us they thought the individuals were volunteers, not paid employees.

Department Action: Corrective action completed.

The Department of Corrections (Corrections) reported that neither its administration nor the prison's warden at the time was aware of the representations made by the employee to establish the association as a nonprofit organization. The current warden and Corrections' regional administrator have determined that it is in Corrections' best interest to reopen the museum due to its historical importance. As a result, Corrections is currently considering reopening the museum as a nonprofit entity, under the direction of an outside independent board of directors. However, before it reopens the museum, Corrections will insure that its tax status is properly established and that adequate accounting procedures are established. Corrections has referred the issue of tax withholding to the Franchise Tax Board for its review.

DEPARTMENT OF CORRECTIONS

Investigations of Improper Activities by State Employees, Report I2001-1

ALLEGATION I990136, APRIL 2001

We investigated and substantiated an allegation that vehicle maintenance officers and senior staff at the Department of Corrections' (corrections) Southern Transportation Unit (STU) had their privately owned vehicles repaired by a vendor that also repairs the STU's state vehicles, and that some individuals received discounts from the vendor. We also substantiated other improper activities. Specifically, we found:

Audit Highlights . . .

Employees of the Department of Corrections engaged in the following improper governmental activities:

- ☑ *One employee received a gift from a state vendor in the form of reduced vehicle registration fees.*
- ☑ *Created the appearance of a conflict of interest by directing substantial state business towards a vendor who also repaired their personal vehicles.*
- ☑ *Circumvented controls over repairs and modifications and did not hold the vendor accountable for failed repair work.*

Finding #1: One employee improperly received a gift and created the appearance of a conflict of interest.

One employee improperly received a gift in the form of reduced registration fees when he purchased a car from a dealership whose owners also own an automotive repair shop used regularly by the STU. The employee, whose duties place him in frequent contact with such vendors and give him the ability to influence which vendors management selects, purchased a sport utility vehicle from the dealership for $17,602. However, the purchase price reported to the Department of Motor Vehicles (DMV) was only $10,000. Thus, the employee benefited in the form of reduced registration fees associated with the sale.

Finding #2: Other employee transactions created the appearance of a conflict of interest.

Four employees, all of whom held positions that enabled them to authorize or influence the amount of state business a vendor received, created the appearance of a conflict of interest when they used one vendor to perform the majority of the STU's repairs while the same vendor also repaired their personal vehicles. One of these employees, a manager, said he instructed staff to use the vendor as the primary vendor of choice for maintenance and repairs of STU's fleet after performing his own analysis and receiving input from his vehicle maintenance officers. However, his analysis conflicted with what the previous STU manager had found—that is, that several qualified vendors offered comparable services and prices. She decided to stop using the vendor when she noticed the vendor

engaged in an apparent pattern of excessive repairs and when she became aware that several employees were taking their personal vehicles to the vendor and were allegedly receiving discounted prices. Despite her concerns, shortly after she left the STU on July 14, 1997, the STU again began using vendor A almost exclusively.

In addition, from March 1998 through March 2000, we found at least five employees used the vendor for maintenance and repairs on their personal vehicles. Although we did not find any direct evidence that all these employees received vendor discounts, certain aspects of their transactions were questionable. For instance, one document included information that appeared to indicate a manager received a $45 discount. We also noticed on the invoice that the vendor failed to charge the manager for oil disposal fees commonly associated with the type of service provided. Such transactions, coupled with the significant increase in state business the vendor received, contributed to the appearance of conflicts of interest.

Finding #3: The STU circumvented controls when purchasing high-cost repairs from the vendor, failed to hold the vendor accountable for failed repair work still under warranty, and paid the vendor to make modifications without obtaining the appropriate approval.

We found at least five instances in which the State paid for repairs in excess of $500 after the STU either encouraged or allowed the vendor to split the cost of the repairs over multiple invoices in order to circumvent the approval process. In addition, the STU did not collect for failed repair work still under warranty. For example, the STU paid $1,300 to the vendor for replacing a computer module, ignition switch, and alternator on a state vehicle. Two weeks and less than 1,000 miles later, the vehicle experienced similar problems, yet the STU paid the vendor approximately $632 to install another computer module. The STU also paid the vendor to make vehicle modifications without obtaining the appropriate approval. For instance, the STU used the vendor to install cruise control for $384 and air horns for $105 on a state vehicle without obtaining the appropriate approvals.

Department Action: Pending.

Corrections agreed that one employee received a gift in the form of reduced vehicle registration fees, but could not develop a preponderance of evidence that the employee was responsible for misreporting the vehicle sales price. Corrections also agreed that STU employees circumvented controls over repairs by allowing invoices to be split. Corrections' investigative and audit reports have been forwarded to the appropriate hiring authority within Corrections to determine what action should be taken.

DEPARTMENT OF CORRECTIONS

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

REPORT NUMBER 2001-108, NOVEMBER 2001

Audit Highlights . . .

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

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

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

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

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

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

Department Action: Corrective action taken.

The department reported that it has reconciled its budget authority to its spending plan for fiscal year 2000–01. It also stated that the spending plans would be adjusted throughout the year when it receives executive orders and budget revisions that impact the department's spending authority. The Office of Financial Management will continue to ensure that the final spending plans align with the final spending authority.

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

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

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

➲ ***Department Action: None.***

The department states that it cannot comply with this recommendation due to a lack of staff resources or adequate data systems. The department also believes that the prescribed time frames for submittal of the reports is unrealistic given the current parameters for securing month-end accounting data necessary for preparing the reports. The department is currently preparing a feasibility study report related to the acquisition of an Enterprise Resource Planning Business Information System, which, if approved, will provide the department with the ability to generate more detailed expenditure reports. However, we believe the department's current data systems are adequate for preparing the suggested report.

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

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

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

Department Action: Pending.

The department contracted for an independent review to develop a new base budget methodology that will provide cost measurements (standard costs) that represent the department's true costs. Once the new methodology is developed, the department states that it will periodically update its standard costs as needed.

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

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

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

Department Action: Partial corrective action taken.

The department's automated monthly budget plan has been implemented statewide and effective November 1, 2001, the department is conducting monthly evaluations of the plans. The department also stated that it will conduct monthly fiscal briefings to the directorate and that any programs that have not submitted corrective action plans will be contacted and required to do so.

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

The department asserted that there are 12 causes for its recurring budget shortfalls; however, we found that the department's conclusions as to the origins of these deficits were often lacking what we would consider sound financial analysis. Specifically, the department's analysis for 8 of its 12 asserted causes lacked a

comparison of budget-to-actual expenditures and the department could not provide support for the base values used in one analysis. In addition, we found that although the department may have incurred shortfalls in particular expenditure line items, in two cases a higher level analysis of the expenditure category or program indicated that sufficient funds were available in other line items to cover the shortfall.

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

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

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

The department reported that it is now continuously reconciling its spending plans with its spending authority and that its monthly budget plan review provides an effective tool for monitoring the department's overall fiscal condition. However, the department did not address whether it would conduct a program analysis in conjunction with its expenditure line item reviews.

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

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

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

➲ ***Department Action: Pending.***

The department stated that it has been aggressively pursuing enhanced recruitment policies (made possible by an increase in funding authority from the administration and the Legislature) with positive results. The number of cadets that graduated in fiscal year 1998–99 was 1,214 versus 1,830 projected for fiscal year 2001–02. The department reported that it will continue aggressive recruitment efforts. The department also reported that it is controlling sick leave usage to the extent possible under federal and state laws. The director stated that he will continue to take appropriate steps regarding the abuse of sick leave, but did not indicate what these steps would entail.

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

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

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

Department Action: Pending.

The department is in the process of developing a three-year workers' compensation cost containment strategy plan. The plan includes six areas that will aid the department in controlling workers compensation costs. The six areas include a fraud program, partnering with other agencies, identifying the role of the return-to-work coordinator (RTWC), developing tools to improve case management, providing education and training to the RTWCs, and developing ways to streamline the process. The Legislature also authorized six new positions in the fiscal year 2001–02 budget for a new program to assist in combating workers' compensation fraud within the department. The department reported in November 2001 that this program is currently being implemented.

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

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

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

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

Department Action: Pending.

The department believes it is too early to conclude that one job placement program is better than the other and is waiting for the results of two studies before making decisions on which program warrants future funding. One study is not due until approximately January 2004. In addition, the department is attempting to reduce the average cost of Continuum by increasing parolee participation, examining site locations to determine optimal placement, and will explore the feasibility of changing the reimbursement process for existing Continuum contracts.

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

The department paid but could not support nearly $24,000 in indirect contract costs to the Jobs Plus contract administrator. In addition, the department could have saved $150,000 if it had

negotiated the current federal indirect cost rate instead of the rate in its contract with Jobs Plus. Using the federal rate is not uncommon as the department used an even lower rate in its previous contract with Jobs Plus.

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

Department Action: Pending.

The department stated that it will investigate the feasibility of adopting the federal indirect cost rate in future contracts. Depending on the results of the feasibility study, the department may require a review of all cost allocation plans that exceed the guidelines developed. However, the department believes that reviewing all cost allocation plans creates a workload and staffing issue, which the department does not have the resources to address at this time. Alternatively, the department will require contractors to retain a current cost allocation plan and will review the plan and recover any unsupported charges during any audits it conducts.

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

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

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

Department Action: Pending.

The department stated that discussions with primary and second-tier providers have focused on strategies to streamline the payment process and to establish clear lines of communication, with the primary objective to alleviate cash flow problems to all levels of service providers, including third-tier subcontractors. It also responded that specific discussions may include a requirement for all second-tier contractors to include a notification to all third-tier contractors of the appropriate department address, telephone number, and contact person to be contacted if any payment problems occur. The department has also assessed the current payment flow and implemented changes to the current contracts, which allows a smoother and more efficient payment flow to all levels of service providers. Specifically, the modifications permit second-tier subcontractors to receive direct payments from the State Controller's Office, thereby eliminating the first layer in the original payment design. The department will also revise future contract language to provide contractors with department personnel and phone numbers to address program contract and payment issues that may arise.

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

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

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

Department Action: Pending.

The department reported that it will revise contract language to require that subcontractor information is included in all future contracts. It also stated that it is developing training material to provide contract-monitoring training to its major programs. The department is examining the feasibility of identifying and sampling contracts for review where problems are more likely to occur. To streamline and eliminate overlapping administrative functions for one program, the department restructured the contract to more clearly define responsibilities and implemented a revised invoice procedure that places the responsibility for the invoice review with the contract's administrative intermediary. Finally, the department plans to formalize policies and procedures for the review of documentation in support of subcontractor invoices that are reviewed by the primary contractor. However, the review will be reserved for limited cases based on department staffing levels.

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

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

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

Department Action: Pending.

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

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

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

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

Department Action: Pending.

The department reported that it is taking all available steps to fully implement the recommendations.

DEPARTMENT OF CORRECTIONS

Though Improving, the Department Still Does Not Identify and Serve All Parolees Needing Outpatient Clinic Program Services, but Increased Caseloads Might Strain Clinic Resources

REPORT NUMBER 2001-104, AUGUST 2001

Audit Highlights . . .

Our review of the Parole Outpatient Clinic Program (program) at the Department of Corrections (department) found that:

- ☑ *The program's new continuum process, while an improvement over its previous process, still does not identify and serve nearly 40 percent of mentally ill parolees.*
- ☑ *In 38 of the 83 cases we reviewed, social workers did not perform prerelease assessments, and 45 parolees were not seen by the clinics within required time frames.*
- ☑ *A new data management system, when implemented, may address some of the program's weaknesses, but it would be more effective if linked to other department computer systems.*

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The Joint Legislative Audit Committee requested that we review and evaluate the goals of the Department of Correction's (department) Parole Outpatient Clinic Program (program) and determine whether the department has adopted reasonable strategies to achieve these goals. The program serves parolees who have mental health needs as well as other parolees who can benefit from psychiatric treatment, such as sex offenders or violent offenders. These parolees receive treatments, including individual or group therapy and medication management, as determined necessary by the program's clinical staff. We found that the program has failed to serve many of the parolees that the department has determined could most benefit from its services. Specifically:

Finding #1: The department has failed to identify and treat a large number of parolees who had been diagnosed as mentally ill when in prison.

Although the program's recently implemented Mental Health Services Continuum Program (continuum process) has increased the proportion of mentally ill parolees it serves, a significant number are still not served. Additionally, the continuum process originally did not include inmates receiving inpatient Department of Mental Health treatment or participating in the Crisis Beds program, both of which include the more severely mentally ill, and therefore may pose a more significant risk to the public. However, the program advised us that it will amend its process to include inmates in these categories. The program has also developed a new data management system that it believes will allow it to better identify and serve all mentally ill parolees. However, the program estimated that this system would not be operational until the end of August 2001.

☑ *One-third of the parolees served by the program are not diagnosed with a mental illness but fit other criteria established by the department.*

☑ *The program should establish caseload standards and use its new system to identify its cost of serving different types of parolees so it can manage expected caseload increases.*

Before October 2000 the department relied on parole agents to refer parolees for evaluation and treatment. This process was not effective, and almost half of the nearly 24,000 mentally ill parolees that went on parole between July 1998 and September 2000 received no treatment at the parole outpatient clinics (clinics). Although the program implemented the continuum process for inmates scheduled for parole on or after October 1, 2000, it still failed to serve almost 40 percent of the more than 6,000 mentally ill parolees who went on parole between October 2000 and March 2001. This is far short of its goal of serving all mentally ill parolees.

We recommend that the program complete the implementation of its new data management system. After implementing the system, the program should identify parolees whom it failed to identify as needing services and ensure that they receive the treatment they need. In addition, it should implement its plan to include in its continuum process those parolees designated while in prison to have been in the Department of Mental Health inpatient and Crisis Beds programs.

To determine the progress the program has made in identifying and serving mentally ill and other parolees, the department should reassess the program one year after implementing the new data management system. The department should submit the completed assessment to the Youth and Adult Correctional Agency.

Department Action: Partial corrective action taken.

In its 60-day response, dated November 5, 2001, the department stated that it has installed its new data management system in two of its four regions and expects to have it fully installed and operational by December 15, 2001. To identify parolees who were not sent to the program for treatment, the department will be asking its parole agents to review their parolees' records and refer to the program those parolees who were classified as mentally ill while in prison but who have not been seen by the program during their parole. It also stated that it is in the process of amending its prerelease contracts to include those parolees designated while in prison to have been in the Department of Mental Health inpatient and Crisis Beds programs. It expects to have these amendments in place by January 2002. The department is currently working to develop a contract, that will provide an evaluation of the program. It expects to have developed the scope of the evaluation by January 2002, and then it will select a contractor to perform the evaluation.

Finding #2: The program does not always perform needed prerelease assessments or provide timely services.

As part of the continuum process, the department established guidelines requiring all inmates diagnosed with mental illness to be assessed before leaving prison on parole and that the parole clinics should see the newly released parolees within specified time frames. However, the program did not complete prerelease assessments for 38 of the 83 mentally ill parolees whose cases we reviewed, even though it had determined that these assessments were needed to properly identify and serve the inmate once on parole. Additionally, program clinicians saw 45 of these 83 parolees outside of the time frames the department has established in order to ensure that mentally ill parolees receive the treatment needed to protect the public and the parolees themselves. In 28 of these 45 cases, parolees were seen within 30 days after parole, but for the other 17, initial appointments did not occur until between 32 to 119 business days after parole.

We recommended that the program use its new data management system to monitor its contractors to ensure that they complete prerelease assessments on all mentally ill inmates scheduled for parole and that its clinics see mentally ill parolees within required time frames.

Department Action: Corrective action taken.

The program has assigned a program manager to monitor the contractors' performance in completing prerelease assessments. In addition, the program is using the new data management system to track the status of prerelease assessments of mentally ill inmates who are within 90 days of release from prison. Finally, the department has designed the system to ensure that its clinics see parolees within required time frames and has dedicated staff to ensure that this occurs.

Finding #3: The program's process for identifying parolees that need its services is not always effective.

Each month, the department provides the program with a list of mentally ill parolees due for parole within the next 120 days. The program then assigns each of the parolees on the list to a social worker, who then enters the information from their assessment onto the system. However, according to the program, the computer program developed to extract the information from the department's systems did not include all specified mentally ill inmates, so the lists the department produced for the program

were incomplete. Indeed, using this process, the program failed to identify and serve almost 39 percent of mentally ill inmates beginning parole terms between October 2000 and March 2001. At least part of this was due to problems identifying all mentally ill inmates about to be paroled.

Linking the program's new data management system to other department systems could improve its efficiency. We believe that if the program automated this exchange of information between the department's systems and the program's new system, it could provide more timely and complete information to the program, reducing the chances of its failing to identify inmates, and therefore, not providing them with needed services.

To more effectively identify all the parolees the program will serve, the program should link its new system to other department computer systems containing the information needed to do so.

Department Action: Pending.

The department is still exploring options that may be available to share data among its various department systems.

Finding #4: The program may not have the resources to serve all parolees that are not mentally ill but meet other criteria for treatment services.

The department has included in the designated population certain parolees who have problems other than mental illness—such as sex offenders and violent offenders—because it believes that they can benefit from psychiatric services provided by the program.

We found that between October 2000 and March 2001, the program failed to identify and serve more than 66 percent of sex offender parolees who were paroled during this period, even though it was required to serve this population. However, if the program were to implement an effective identification process, it may not have the resources to serve the increased caseloads.

The department should ensure that the program has adequate processes and resources to identify and serve parolees with problems other than mental illness.

Department Action: Pending.

In the future, the department intends to collect data on the time and resources it uses to treat parolees with problems other than mental illness. If through this process it identifies a need for additional resources, it will pursue them through the annual budget process.

Finding #5: The program should take additional actions to manage expected caseload increases.

The program's current data management system is not able to identify the level of effort—and related expense—that it incurs in treating the various types of parolees in its program. For example, a clinician may treat several different types of parolees: the mentally ill, serious sex offenders, and violent criminals. Because the program has not tracked the time clinicians spend providing services, it is not able to track how much of its resources it uses on the various types of parolees receiving treatment. Although its current system cannot collect this information, the program has an opportunity to use its new data management system to begin collecting the data it needs to determine the costs of services it provides to the different types of parolees. To accomplish this, the program would have to establish a unique designator for each type of parolee it serves, record the amount of time that clinicians spend with different types of parolees, and include all of its parolees on the system.

Moreover, the program has not developed caseload standards so that it can adequately monitor and assess the caseloads of its clinicians. The program could use standards to better evaluate its efforts, and to assess and justify the need for changes to its staffing as its workload changes.

To better identify its costs of treating parolees and to better justify additional resources it may require, the program should track the amount of time and resources it spends treating the different types of parolees.

To appropriately assess its clinicians' workloads and evaluate the need for additional resources, the program should develop caseload standards for its clinicians.

Department Action: Partial corrective action taken.

The department's new data management system will track the number and duration of treatments provided to mentally ill parolees. After the first year of operation, it intends to capture similar information for parolees it serves with problems other than mental illness. The department stated that it would explore opportunities to establish caseloads standards for its clinic staff.

DEPARTMENT OF CORRECTIONS

Poor Management Practices Have Resulted in Excessive Personnel Costs

REPORT NUMBER 99026, JANUARY 2000

Audit Highlights . . .

Our review of personnel management practices at the California Department of Corrections' (department) prison facilities disclosed:

- ☑ *It would save between $17 million and $29 million a year by being more effective in curbing excessive sick leave use.*
- ☑ *Additional savings of at least $5.5 million a year could be realized by optimizing its mix of full-time relief officers and permanent intermittent employees to fill in for predictable absences.*
- ☑ *The department has no strategy for ensuring that custody staff take time off for holidays and other leave they earn each year. As a result, it is faced with a $79 million liability that is growing by more than $8 million each year.*
- ☑ *Poor management information has hindered the department's ability to better control and contain personnel costs.*

As required by the Budget Act of 1999, we reviewed the management of personnel at prison facilities operated by the California Department of Corrections (department). Specifically, we were asked to review personnel practices at a sample of state prisons and recommend what changes, if any, were warranted to hold down state overtime and other personnel costs, comply with state civil service laws and professional management practices, and ensure good employee relations.

Our audit revealed problems in the department's management of sick leave usage and leave programs and addressed high overtime costs largely driven by the significant use of sick leave at the department's prison facilities. To determine the department's progress in implementing our recommendations and improving its management of personnel resources, we made limited inquiries and performed a limited review of documents at department headquarters. We found that the department has not fully implemented the majority of our recommendations. In addition, the actions the department has taken to address its problems have been ineffective, as both sick leave usage and overtime costs have increased since we conducted our audit.

After we issued our February 2001 special report to the Assembly Budget Subcommittee Number 4, titled *Implementation of State Auditor's Recommendations*, the department sent us a response on April 5, 2001. We sent a follow-up letter to the department on June 29, 2001, to provide clarity and perspective on a number of the comments the department made in its response. For example, our report identified a growing liability for unused vacation and holiday leave for custody employees. We identified two cost-effective ways to address this problem; namely, hiring entry-level custody staff or reducing the liability by cashing out the leave at straight time. Instead, the department indicated that it is reducing the liability by paying overtime, which is more costly than either of the methods we recommended. Since the department's April 5 letter generally indicated no change regarding the status

of implementation of our recommendations, below we present the same summary of the issues as we reported them in February 2001, except as indicated on the following pages.

In addition, item 5240-001-0001 of the supplemental report of the 2001 Budget Act required the department to report to the Joint Legislative Budget Committee and the fiscal committees of both houses by January 10, 2002, on its effectiveness in reducing sick leave usage, increasing the appropriate usage of budgeted vacation and other leave time, and on its estimate of the net fiscal effect of these changes on department personnel expenditures and the outstanding fiscal liability related to the vacation and holiday leave obligations. As of February 8, 2002, we understand from the Legislative Analyst's Office that the department has not yet delivered the report.

Finding #1: Poor sick leave management practices have caused excessive overtime costs.

Specifically, we found that the department is not effective in disciplining employees who use excessive sick leave. In addition, the institutions do not analyze sick leave data sufficiently and are not optimizing the use of permanent full-time relief employees and permanent intermittent employees to fill in when certain custody employees are out sick. By being more effective in curbing excessive sick leave, the department could save between $17 million and $29 million a year.

We recommended that the department take progressive disciplinary action against employees it believes use excessive sick leave, negotiate with the bargaining unit to establish financial incentives for employees who use less sick leave and disincentives for those whose use is excessive, and collect more information regarding leave usage. In addition, the department should determine an appropriate number of full-time relief employees to cover for sick leave and optimize the use of permanent intermittent employees.

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

Contrary to what the department reported in its six-month response to our audit, sick leave usage has continued to rise at the institutions. In its six-month response the department indicated that sick leave usage had declined when comparing the months of January to June 2000. However, the data the department used in its calculations included hours used by administrative employees whose positions do not need to be

filled when they are absent. Instead of simply comparing sick leave usage for two separate months, we calculated an annual average using the first nine months of 2000 and found that sick leave usage by custody staff has increased overall when compared to fiscal year 1998–99. Although the yearly average for sergeants decreased slightly by about 2 hours, the averages for correctional officers increased by about 6 hours and lieutenants by about 13 hours. Because the number of correctional officers is so much larger than the number of sergeants and lieutenants, sick leave use overall increased.

The department indicated that overall the institutions have used disciplinary tools, such as the extraordinary use of sick leave list and counseling, to curtail the use of sick leave. However, we found that some institutions are not as aggressive as others in their use of the tools. In fact, the institutions that have used these tools less extensively are generally paying higher amounts of overtime to cover for sick leave absences.

Regarding the establishment of financial incentives for employees who use less sick leave and disincentives for those whose use is excessive, a department representative indicated that internal discussions have occurred, but there have been no formal negotiations with the union representing custody staff on this issue. The current agreement between the State and the union expired in July 2001.

The department has been collecting from its institutions additional data regarding sick leave usage and the resources and its associated costs. While the department has used this data to generate tables and reports on the amount of sick leave and the various types, the fact that sick leave usage has increased indicates that the department has not successfully utilized the information to better manage sick leave.

When sick leave usage is high, the use of permanent intermittent employees (PIEs) to fill in for absences is an important part of keeping overtime costs down. Although the institutions have begun tracking the hours PIEs work, department headquarters has only recently started to obtain this information. The department also established new procedures requiring wardens or their designees to conduct a daily meeting to discuss the previous day's overtime, PIE usage, and sick leave. However, these meetings do not appear to be having the desired effect. For example, we found that one institution

incurred about $500,000 in overtime costs even though its reports on PIE usage for the period indicated there were PIEs available almost every day.

Furthermore, the department has not developed scheduling methods that encourage PIEs to work when they are needed, and has not taken steps to eliminate nonresponsive PIEs from the hiring pool. The department reported it is still considering whether to develop different scheduling methods for PIEs. In addition, the department is reluctant to dismiss nonresponsive PIEs because of the 16 weeks it invests in training them. Finally, although it acknowledges more should be done to understand why PIEs are nonresponsive, the department has issued no instructions to the institutions regarding how to deal with this situation.

Finding #2: The department is facing a large liability related to unused leave balances.

We found that the department allows employees to exceed maximum vacation and annual leave balances. In addition, the department has not established practices to ensure that staff use all or most of the leave they earn each year. As a result, the department is faced with a $79 million liability, with holiday leave alone growing at $8 million per year. Furthermore, inadequate funding for vacation leave relief and the department's inflexible leave practices related to approving time off curtail opportunities for staff to use their leave time.

We recommended that the department develop a plan to eliminate its significant leave liability, enforce mandatory limits on accumulation of vacation and annual leave, and develop strategies to ensure holiday leave is used during the year it is earned. In addition, the department should seek to adjust its funding for sick and vacation leaves to ensure that its budget is appropriately and sufficiently aligned with the expenditure of personnel resources. The department should also develop more flexible practices for authorizing time off.

Department Action: Pending.

Based on information from the State Controller's Office leave accounting system, total accrued leave balances for custody staff decreased almost 2 percent between March and July 2000. This was mostly attributable to a 3 percent (86,900 hours) decrease in accrued holiday leave. However, accrued vacation increased by 27 percent (49,800 hours) and annual leave

by 12 percent (10,300 hours). The department could provide no explanation for the overall decrease in leave balances during this period as it had taken no specific actions targeted at reducing the balances.

In particular, the department has not required custody employees with large leave balances to take time off. A case went to arbitration over whether management can direct employees to take time off. The California Correctional Peace Officer Association filed a grievance stating the department did not have the right to force employees exceeding or projected to exceed leave caps to use the leave. In January 2001 the arbitrator ruled against the department in this particular case because of the way it scheduled vacations. However, he agreed that the department could develop new procedures for "burning" excess vacation as long as it fulfills its contractual obligation to bargain with the union.[1]

In addition, the department indicated it has not been able to hire additional staff to cover for leave absences because the number of PIEs graduating from the academy has not been sufficient to meet additional needs.

Furthermore, the department submitted a proposal to the Department of Finance and Department of Personnel Administration to allow for the buying back of leave. Although its proposal was not approved, the department was included in a statewide leave buyback for all supervisors and managers for fiscal year 2000–01. As of November 30, 2000, custody staff had cashed out 46,040 hours of leave. While this helped in decreasing leave balances, the correctional officer position was not eligible to participate. As a result, leave balances for the largest group of custody employees was not affected. The department stated that it plans to seek approval for another leave buy-back opportunity.

The department disagreed with our recommendation to reduce funding for sick leave usage. According to its six-month response, the department believes that 72 hours of sick leave per year for each posted position is reasonable based on its survey of six metropolitan jails. Accordingly, it asked for and

[1] We added clarifying comments to this paragraph based on the department's April 5, 2001, response to our special report to Assembly Budget Subcommittee #4 issued in February 2001.

obtained approval for funding at that level. It also received increased funding for vacation relief to match the amount that custody staff earn in a year.

Finally, the department acknowledges that its leave practices have been inflexible. However, it has done little so far to provide staff additional opportunities to take time off. The department has changed the timelines related to requesting leave days on short notice. Previously, some institutions required that bids for leave days on short notice be received as much as 90 days in advance. Since September 2000 all institutions are allowed to accept requests for days off 30 days before the desired date. While this allows staff a better chance to obtain an extra leave day on short notice, it does nothing to increase the number of requests that can be granted. To make matters worse, in researching leave practices at the institutions, the department found that holiday and vacation relief officers are not always being used for the assigned purpose. This practice further limits the opportunity for staff to get days off.

Finding #3: Poor management information prevents the department and its institutions from controlling personnel costs and effectively allocating personnel resources.

Institutions have not adequately studied daily staffing needs and leave patterns to determine the level of relief needed to cover predictable absences. Nor does the department sufficiently link the use of personnel resources to the institutions' budget. In addition, we found that the institutions do not always accurately record the regular overtime activities of their employees, which diminishes the effectiveness of management information.

We recommended that the institutions study their daily resource needs, determine baseline staffing levels, and hire enough permanent full-time employees to meet these minimum daily needs. In addition, we recommended that the department develop an institution-wide system that compares the personnel budget for its major activities to the actual level of effort spent using full-time employees, permanent intermittent employees, and overtime in carrying out those activities. We also recommended that the institutions accurately track and record the regular and overtime activities of their employees.

Department Action: Partial corrective action taken.

The department directed each institution to create an overtime avoidance pool (OTAP). The OTAP is designed to fill vacancies and reduce overtime costs. The number of employees to be included in the OTAP is based on the smallest number of daily sick absences each institution incurred over and above the budgeted relief over the last 6 to 12 months, plus the fewest number of other posts to generate overtime over the past 3 months. However, department data shows that some institutions have not filled all the needed OTAP positions that were identified and overtime costs increased for the fourth consecutive year.

➲ The department indicated in its 6-month response that overtime had decreased when comparing the month of January 2000 to the month of June 2000. However, we found that the department's own data showed that overtime increased on the whole for fiscal year 1999–2000 to the highest level in the last four fiscal years. Further, the data the department used for its calculations included other costs besides the overtime paid to custody staff. When using data on actual overtime paid to custody staff, we found that overtime actually increased from January to June, not decreased as the department reported.

While we recommended the department develop an institution-wide system to compare budgeted personnel for its major activities to the actual level of effort spent using overtime, permanent intermittent employees, and its permanent full-time employees, the department has yet to do so. By not having a process to provide this type of information, managers at institutions cannot know how their resources are being used and how their use compares with the budget.

Finally, to improve the accuracy of information on employee activities, the department indicated that it provided training to staff responsible for recording this information.

DEPARTMENT OF EDUCATION

Investigations of Improper Activities by State Employees, Report I2001-2

ALLEGATION I990003, SEPTEMBER 2001

Audit Highlights . . .

Two former supervisors of the Department of Education engaged in the following improper governmental activities:

- ☑ *They violated or appeared to violate revolving door prohibitions after leaving the State to work for state contractors.*
- ☑ *Education's legal office contributed to the conflicts of interest by providing flawed advice.*
- ☑ *One supervisor interviewed with a contractor while overseeing the state's review of its operations.*

Along with the Fair Political Practices Commission (FPPC), we investigated and substantiated an allegation that two former supervisors in the Child Development Division (child development) of the Department of Education (education) violated or appeared to violate conflict-of-interest laws after they left education to work for organizations that had contracts with the State. We also substantiated other improper activities. Specifically, we found:

Finding #1: Two former supervisors violated or appeared to violate conflict-of-interest laws after leaving the State.

One supervisor improperly communicated with education employees on behalf of a contractor within 12 months of leaving education to work for the contractor regarding a $3.8 million contract she helped oversee while employed by the State. She also violated conflict-of-interest laws when she advised and assisted the contractor with the same contract. The FPPC also concluded that another supervisor might have violated conflict-of-interest laws when he made inappropriate contact with education on behalf of a contractor within 12 months of leaving state employment.

The FPPC informed education that its legal office may have been giving employees incomplete advice and, more specifically, that the advice offered to the supervisors did not consider "revolving door" sections of the Political Reform Act. Relying on education's flawed advice, both supervisors began their new jobs with the understanding that no legal problems existed. The FPPC did not take any formal enforcement action against the supervisors because they relied on faulty legal advice, they cooperated fully with the FPPC's investigation, and the FPPC found their activities resulted in little or no harm to the State.

Finding #2: One supervisor engaged in incompatible activities.

We determined that one supervisor engaged in incompatible activities. For example, he personally benefited when he flew to Southern California to interview for a job with a contractor at the same time he was purportedly participating in a state review of the contractor's operations. In addition, the supervisor planned to use state resources to provide an unprecedented level of technical assistance to the contractor. Furthermore, both before and during the review, education conducted an investigation of allegations concerning the contractor. Although investigators expressed concern that the supervisor lacked impartiality and could compromise the ongoing investigation, he remained involved with the contractor. At the very least, the supervisor's continued involvement with the contractor created the appearance of a conflict of interest, and we found some evidence that his involvement interfered with education's investigation.

Department Action: Corrective action taken.

Education agrees that its legal office provided flawed advice to the two supervisors and that they appeared to have violated conflict-of-interest laws. The attorney who provided the flawed advice is no longer an education employee, and education has made its legal staff aware of the conflict-of-interest laws and revised its incompatible activities policy to ensure that all employees clearly understand what activities are not allowed. In addition, education offers training to its managers on conflict-of-interest and incompatibility prohibitions to ensure that the managers are conducting their activities in accordance with the law and to enable them to monitor and guide the activities of their staff. Furthermore, education gives all employees who leave state employment a memorandum reminding them of the restrictions on their post-employment activities.

STANDARDIZED TESTS

Although Some Students May Receive Extra Time on Standardized Tests That Is Not Deserved, Others May Not Be Getting the Assistance They Need

REPORT NUMBER 2000-108, NOVEMBER 2000

Audit Highlights . . .

Our review of the process for granting extra time on standardized tests to students with learning disabilities revealed that:

- ☑ *Very few students receive extra time on standardized tests such as the Scholastic Aptitude Test (SAT), ACT, and the Standardized Testing and Reporting exam.*
- ☑ *Wide demographic disparities existed between those 1999 graduating seniors who received extra time on the SAT and those who did not.*
- ☑ *Some deserving students may not be receiving the accommodations they need on standardized tests because schools and parents are not aware of Section 504 of the Rehabilitation Act of 1973.*
- ☑ *Some undeserving students may be receiving extra time on standardized tests; however, the potential magnitude of this problem is limited.*

We reviewed the process for granting accommodations to students with learning disabilities when taking college admissions tests, such as the Scholastic Aptitude Test (SAT); ACT, formerly known as the American College Testing Program; and other standardized exams, including those administered under the Standardized Testing and Reporting (STAR) program.

To help compensate for their disabilities, disabled students often need accommodations on school work and standardized tests, such as extended time, scribes, or large-print formats. Two federal laws, the Individuals With Disabilities Education Act (IDEA) and Section 504 of the Rehabilitation Act of 1973 (Section 504), ensure that disabled students receive the educational services they need and are not subject to discriminatory practices. Students eligible for accommodations on standardized tests typically qualify for special education under IDEA and have individualized education programs (IEPs) or have Section 504 plans. IEPs and Section 504 plans are tailored to meet the individual needs of students with disabilities and serve as agreements outlining the services schools will provide. Our audit revealed the following:

Very few students receive extra time on standardized tests. For example, less than 2 percent of the 1999 graduating seniors nationwide who took the SAT received extra time, and in California, the rate was less than 1.2 percent. Likewise, less than 2 percent of the 4.2 million California students in grades 2 through 11 who took the STAR exam during the 1998–99 school year received extra time. Although few students received extra time on the SAT, those who did were disproportionately white or were more likely to come from an affluent family or to attend a private school. Such disparities did not exist for students taking the STAR exam.

Finding #1: Some deserving students may not be getting the assistance they need on standardized tests.

Because so few students receive accommodations on standardized tests, it appears that some students might not be getting the assistance they need. In fact, among 1,012 public schools and 584 private schools with seniors who took the exam, not one 1999 graduating senior received extra time on the SAT. This represents 70 percent and 73 percent, respectively, of all such public and private schools in California. While the cause of this problem may vary from district to district, lack of awareness of Section 504 and weaknesses in district processes for identifying students with suspected disabilities would seem to be contributing factors. The two school districts in our sample—San Francisco Unified and Los Angeles Unified—with below average percentages of students receiving extra time on the SAT also had low percentages of students with Section 504 plans compared to the other districts we visited. Los Angeles Unified School District has been criticized for having a weak process for identifying students with disabilities.

To ensure that students with learning disabilities are identified and receive the services they need, we recommended that all California school districts ensure compliance with the requirements of Section 504. Specifically, procedures should exist to identify and evaluate students with disabilities and to ensure that all eligible students receive the accommodations they need. Additionally, districts should ensure that staff, parents, and students are aware of services available to eligible students under Section 504.

District Action: Corrective action taken.

To increase Section 504 awareness, Los Angeles Unified School District conducted six Section 504 training sessions for newly assigned administrators and assistant principals, and 38 training sessions for other school staff during fiscal year 2000–01. Through January 2002, it conducted one additional Section 504 staff development session for new assistant principals, and 10 more training sessions for other staff.

Likewise, San Francisco Unified School District has provided Section 504 training to site administrators during the 2001–02 school year, with further training scheduled for spring 2002. The district also sent a memorandum to principals reminding them to review all Section 504 plans to ensure that any student whose plan calls for extra time for test taking receives that accommodation on the Spring 2002 STAR exam.

Finding #2: Some undeserving students may be receiving extra time on standardized tests.

Our review of the files of 330 California students from 18 public schools, most of whom obtained extra time on standardized tests, found that the basis for their accommodations was questionable in 60 instances, or 18.2 percent. The frequency and seriousness of questionable cases varied substantially from district to district. However, because less than 2 percent of total SAT and STAR test takers receive extra time, the potential magnitude of undeserving students receiving extra time is limited.

Six of the seven districts we reviewed did not have adequate records to support the accommodations some students received. However, only San Dieguito Union High School District displayed significant, widespread problems. For example, its incorrect interpretation of Section 504 allowed potentially ineligible students to obtain extra time on college entrance exams. The threat of litigation also caused one district to provide an unwarranted Section 504 plan that was used by a student to obtain questionable accommodations on a college entrance exam. Finally, vague instructions on the College Board's eligibility form and weaknesses in its own approval process may have allowed some undeserving students to receive extra time on the SAT. As a result, these students may have had an unfair advantage over other students taking college admissions tests.

To ensure that ineligible students do not gain an unfair advantage on standardized tests, we recommended that San Dieguito Union High School District revise its policies to ensure that it provides Section 504 plans only to students whose impairment substantially limits a major life activity. Decisions regarding eligibility, placement, and services to be provided should be made only by a team qualified to make such decisions and should be based on the district's own evaluation of disabilities and their impact on learning.

We also recommended that Acalanes Union High School District, Beverly Hills Unified School District, Palo Alto Unified School District, and San Francisco Unified School District provide or request extra time on standardized tests only when such an accommodation is warranted and documented in the student's IEP or Section 504 plan.

District Action: Corrective action taken.

San Dieguito Union High School District revised its Section 504 procedures and all existing Section 504 plans were reviewed for compliance with the new procedures. Students previously receiving Section 504 plan accommodations without appropriate documentation of a current disability and/or evidence of a significant impact on learning have been denied Section 504 plan renewal. Consequently, the number of Section 504 plans for the district decreased from 367 in fiscal year 2000–01 to 184 in fiscal year 2001–02.

Beverly Hills Unified School District states that it will continue to follow and closely monitor its policy of providing an accommodation, such as extended time on tests, only when it is written in a student's Section 504 plan or IEP.

Palo Alto Unified School District states that it continues to follow a formal process for designation of extra time on tests for students with IEPs and Section 504 eligibility. However, the district has revised its Section 504 process to include more specific designations of the need for testing accommodations.

District Action: Partial corrective action taken.

Acalanes Union High School District has incorporated presentations on testing accommodations into its staff development program as a regular activity. The district has also begun a process of revising both its internal operational guidelines for determining and reporting appropriate accommodations for disabilities, and of creating informational pamphlets for public use on these, and other, special education and Section 504 topics. The district's goal is to have both of these tasks completed and implemented by late spring 2002.

San Francisco Unified School District selected a random sample of 10 percent of the special education students who took the Spring 2001 STAR exam with extended time and is manually verifying that those students had extended time as an accommodation in their IEP plans. The district plans to improve its special education database so that in the future it will be easier to verify that students who received accommodations on standardized tests had IEP plans authorizing those accommodations.

STAR PROGRAM

Ongoing Conflicts Between the State Board of Education and the Superintendent of Public Instruction as Well as Continued Errors Impede the Program's Success

Audit Highlights . . .

Our review of the California Department of Education's (department), State Board of Education's (board), and superintendent of public instruction's (superintendent) implementation of the Standardized Testing and Reporting (STAR) program disclosed:

- ☑ *Open conflict between the superintendent and the board as well as errors on the part of school districts and the test publisher have negatively affected the program.*
- ☑ *The superintendent has not developed an annual implementation plan, as law requires.*
- ☑ *During the first two test cycles—spring 1998 and spring 1999—the department did not closely monitor the performance of the test publisher. The program has been plagued with missed deadlines, unreliable data, and inaccurate reporting of achievement test results.*
- ☑ *The department must take further action to ensure the success of the Public School Accountability Act of 1999, such as pushing for better test security.*

REPORT NUMBER 99131, APRIL 2000

The Joint Legislative Audit Committee asked us to conduct an audit regarding the implementation and execution of the Standardized Testing and Reporting (STAR) program. Our audit focuses on the roles and responsibilities of the California Department of Education (department), the Superintendent of Public Instruction (superintendent), the State Board of Education (board), school districts, and test publishers in implementing, administering, and reporting the STAR program. Specifically, we found:

Finding #1: Conflict between the board, superintendent, and department undermine the STAR program.

The California Education Code (code) gives the board the authority to adopt policies for the governance of kindergarten through grade 12 in public schools. The code further states that the role of the superintendent and the department is to administer the board's policies. Historically, the board and the superintendent have not always agreed whether certain issues are matters of policy or administration. The decades-old conflict between these educational bodies continues and has negatively affected all aspects of the STAR program.

To facilitate communication between the board, superintendent, and the department and to create a more productive environment for the STAR program, we recommended that:

- The Legislature should establish a mechanism for appointing a mediator to resolve disputes that will most certainly continue concerning these entities' respective roles and responsibilities.
- With the help of the mediator, the board and the department should establish a memorandum of understanding that outlines their respective roles and responsibilities for implementing the STAR program.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Department and Board Action: Partial corrective action taken.

The department and the board did not address the establishment of a memorandum of understanding but report that they are able to work together without the assistance of an outside mediator. Specifically, legislation giving the department administrative responsibility over the STAR program allows it to provide better direction to the test publisher. Moreover, the department and the board have had weekly meetings to communicate information on testing and to plan STAR administration.

Finding #2: The STAR program lacks an implementation plan.

State law requires the superintendent to submit to the Legislature a plan for producing valid, reliable, and comparable individual student scores. However, the superintendent has not developed such a plan for the STAR program.

We recommended that the superintendent should develop an annual implementation plan as mandated by law. Further, the plan should explain how to communicate instructions to the test publisher and include:

- A decision matrix that shows the representatives who must be present from each entity before a decision is accepted.
- Timelines indicating all anticipated actions to be taken by the board and the department.

Department Action: Partial corrective action taken.

The department did not address the superintendent's development of an annual implementation plan. However, it did report that it has been working continuously with the test publisher to plan a test item-development process, develop procedures for field testing test items, and obtain research information on testing to facilitate the production of valid and reliable test results for both language arts and mathematics. It also states that this work is included in the test publisher's 2001 contract.

Finding #3: Poor communication between state entities causes the test publisher to receive conflicting instructions.

For the spring 2000 test cycle, the department contracted directly with the test publisher. Despite this contract, weak communication among the department, the board, and the test publisher continues. Several times during the spring 2000 test cycle, the board and department gave the test publisher conflicting instructions.

We recommended that the department must continue its weekly meetings with the test publisher, as outlined in the 2000 contract. It should also ensure that it places similar requirements in all future contracts. We also recommended that the board and the department must establish a formal meeting schedule to make sure that the board is kept abreast of ongoing program issues.

Department and Board Action: Corrective action taken.

The department reports it continues to meet and hold conference calls weekly with the test publisher's staff, as required in the test publisher's 2000 contract. A similar requirement is also in the test publisher's 2001 contract. It also reports that both it and the board continue to meet weekly to communicate information on STAR implementation.

Finding #4: The State did not properly monitor the test publisher's performance.

There appears to have been very little monitoring of the test publisher's performance by the department in the first two test cycles, spring 1998 and 1999. The superintendent did not establish a method for working with the test publisher to ensure that the achievement test results are valid, reliable, and comparable, as state law requires. Thus, a clear description of the scope of the work; a timeline for major activities and milestones; a plan for monitoring the test publisher's performance; and defined roles and responsibilities for the department, board, and test publisher did not exist. Consequently, the test publisher's performance during the first two years was problematic, particularly during the spring 1999 test cycle. To improve its performance, the test publisher obtained the services of a consultant to identify breakdowns in its operations and those of its subcontractors.

We recommended that the board and department should review the recommendations of the test publisher's consultant and amend the current contract to ensure that the test publisher does implement all recommendations that will improve the STAR program.

Department and Board Action: Partial corrective action taken.

The board and department report that, where possible, they have ensured that the consultant's recommendations were incorporated into the planning and program procedures for STAR 2001. However, they made no indications that the contract was amended to ensure that the test publisher implements all recommendations.

Finding #5: School district training can increase the integrity of the STAR program.

For the first two years of the STAR program, school district and test publisher errors prevented the department from posting complete and accurate test results for public viewing on the Internet by the yearly statutory deadline of June 30. Delays in reporting accurate and complete test results can have a significant effect on the State's Academic Performance Index (API), which is used to distribute about $150 million earmarked for schools and teachers under the Public Schools Accountability Act of 1999. Currently, the achievement test results comprise 100 percent of the API.

To ensure the integrity of the testing process and the accuracy of the information given, we recommended that the department should calculate the additional costs of requiring all school districts and testing personnel to attend training courses on properly administering the test and accurately reporting necessary demographic information. If the costs are reasonable in relation to the total program costs, the department should take the necessary actions for requiring all relevant personnel to attend this training.

Department Action: Partial corrective action taken.

The department reports that it has taken a number of steps to improve training materials and the training process. For the spring 2001 test cycle, the department intends to provide school districts with an enhanced video training tape to improve training for teachers and test proctors. It also is attempting to revise all testing manuals and pretest workshops to clarify areas that have been problematic. Finally, the department has determined that it does not have legal authority to mandate that all school district staff administering the STAR program attend training classes.

EMPLOYMENT DEVELOPMENT DEPARTMENT

Although New Telephone Services Have Enhanced Customer Access to the Department's Unemployment and Disability Insurance Programs, Customers Encounter Difficulties During Peak Calling Periods

REPORT NUMBER 99031, JULY 2001

Audit Highlights . . .

Our review of the Employment Development Department's (department) introduction of toll-free telephone services for customers of its unemployment insurance and disability insurance programs reveals that:

- ☑ *Its efforts have improved customer service and increased the public's access to the programs.*
- ☑ *Customers of both programs are generally satisfied with the services.*
- ☑ *Despite its efforts, callers may encounter busy signals, hear instructions to call back later, or endure lengthy waits if they ask to speak to a customer service representative during certain periods.*
- ☑ *The department cannot measure whether the programs have met the goals established for desired response times to their customers.*

Chapter 329, Statutes of 1998, directed the Bureau of State Audits to review the effects that the introduction of toll-free telephone services had on the Employment Development Department (department) and customers of its unemployment insurance (UI) and disability insurance (DI) programs. Our review indicates that the department's efforts have improved customer service and enhanced customer access to the programs. In addition, customers of the programs were generally satisfied with the services they received over the telephone. Despite its efforts, the department can make further improvements. Specifically, we found:

Finding #1: During certain periods, customers of the department's UI and DI programs have experienced difficulties when requesting customer assistance. Staffing shortages and phone system failures contributed to the problems the customers encountered.

Callers to the UI program's toll-free telephone numbers have experienced lengthy wait times during certain busy periods. For example, more than 60 percent of the UI program's callers during a peak service period in February 2001 waited on hold five or more minutes to speak to a customer service representative. In contrast, 18 percent waited on hold five or more minutes during December 2000. The department asserted that staffing shortages have contributed to its difficulties in providing prompt customer service. It attributed the shortages in part to the complexities and slowness of the civil service hiring process. Thus, the department has begun to explore alternative hiring methods to reduce the lengthy wait times.

Customers of the DI program experienced staffing shortages as well as other problems. As of April 2001 the program only had 58 percent of the authorized customer service representatives in its two call centers available to take calls. With the staffing shortages, callers may find it more difficult than usual to obtain information. For instance, over a 15-month period from January 2000 through March 2001, the telephone system at DI call centers required nearly 687,000 (27 percent) of the 2.5 million callers who asked for customer assistance to call again. Additionally, nearly 31,000 callers routed to the DI program's call centers received busy signals in the first three months of 2001 when its telephone system faced numerous breakdowns after the installation of new equipment. Only 850 callers encountered busy signals during the same period in 2000.

We recommended that the department continue to explore ways and methods within the State's civil service system to hire and retain customer service representatives. Additionally, the department should consider performing a study to examine the effect on UI call center workloads of increasing business hours for call centers during peak calling periods.

We also recommended for the DI program that the department complete customer service contingency plans and limit the effect and number of system breakdowns during installation of future system changes.

Department Action: Partial corrective action taken.

The department states that it now uses continuous filing in its hiring process to ensure an ongoing pool of eligible candidates for service representatives in the UI and DI programs. Additionally, it proposed to the State Personnel Board changes in the minimum qualifications of the service representatives. The department also states that it is currently performing an analysis to determine the number of staff it should hire for the UI program. In the interim, it temporarily hired approximately 100 employees to assist in the UI call centers. Further, the department studied the effect on UI call center workloads of extending its business hours. It found that the increased hours of operation would not accomplish the desired benefit. However, it has instituted new processes designed to potentially decrease workloads at the UI call centers. For the DI program, the department has increased the number of staff in its call centers and customer service units to alleviate the demands on their workloads.

To limit the effect and number of system breakdowns for the DI program, the department states that it has developed contingency plans and is working to formalize the plans. It has also identified a computer mechanism that allows it to more easily reroute customer service calls when system breakdowns occur.

Finding #2: The department cannot measure for the UI and DI programs whether it has met the goals established for its desired response times to customers.

The department established separate response time goals for its UI call center staff to answer calls requesting information and to answer claim-filing calls. However, since 1999 one of the department's system modifications eliminated its ability to distinguish information calls from claim-filing calls. In addition, reports prepared for management do not detail how well the call centers are doing as far as meeting the goals. The department is evaluating a proposed goal that it can use to measure the response time for all UI customer calls.

The department set a goal for its DI call centers and customer service units to answer in four minutes 90 percent of all calls requesting information. However, it evaluates the program's performance from management reports that do not routinely include the customer service units, which receive 42 percent of the program's calls. Additionally, its management reports do not indicate its performance in meeting its stated goal.

We recommended the department promptly complete for the UI program its process for setting challenging yet reasonable goals for answering customer calls. The department should also modify the DI program's management reports to include the call activity at its customer service units. We further recommended that the department modify the management reports for both programs to measure their performance in meeting their goals.

Department Action: Partial corrective action taken.

The department states for the UI program that it is currently working to reasonably establish response time goals and modify management reports to measure performance. For the DI program, the department has modified its management reports to include call activities at its customer service units and to measure its performance in meeting its goal. Additionally, the department is researching the feasibility of establishing another DI call center to handle most of the calls routed to the customer service units.

Finding #3: The department should conduct planned customer satisfaction surveys of certain UI and DI program customers.

We found that the department has begun only recently to conduct surveys of specific UI customer groups, such as Cantonese- and Vietnamese-speaking customers or teletypewriter users. Prior surveys performed by the department were unlikely to get representation from these groups because their populations are relatively small.

Department Action: Partial corrective action taken.

The department completed for the UI program its pilot surveys of teletypewriter users and customers speaking Cantonese and Vietnamese. Additionally, in its 2001 survey plan, the department proposes to conduct telephone surveys of its Cantonese and Vietnamese customers to obtain feedback on UI services received. Further, the department conducted a survey of DI program customers and plans to report its results in December 2001. It plans another survey of DI customers to be completed by January 2002.

THE STATE-COUNTY PROPERTY TAX ADMINISTRATION PROGRAM

The State and the Counties Continue to Benefit, but the Department of Finance Needs to Improve Its Oversight

REPORT NUMBER 99142, APRIL 2000

Audit Highlights . . .

The State-County Property Tax Administration Program (program) should be continued because:

- ☑ *Loans to assessors generate a significant amount of new property tax revenues that benefit the State, the counties, and other local governments.*
- ☑ *Assessors' offices continue to rely on loan funds to reduce or prevent backlogs of work.*
- ☑ *The program is successful during recessions as well as during times of prosperity.*

Despite the program's success, oversight from the Department of Finance (department) has been weak. As a result:

- ☑ *The department often makes loans based on insufficient and unverified information.*
- ☑ *The department loses track of unspent county loan funds.*

The California Legislature established the State-County Property Tax Administration Program (program) through Assembly Bill 818 (Chapter 914, Statutes of 1995). This program, administered by the Department of Finance (department), allows county assessors to receive performance-based loans from the State to help reduce their backlogs and improve their administration of the property tax system. The Joint Legislative Audit Committee requested that we review the program to see if it is still needed and whether the department and counties have operated the program as intended by the law.

We concluded that continuing the program makes good business sense because the program continues to generate a significant amount of new property tax revenues that benefit the State and the counties. However, despite the program's success, the department needs to make improvements.

Finding #1: The department's oversight of the program has been inadequate.

The department is not managing the program well enough to ensure that loan decisions are based on sufficient information because it does not require the counties to submit the necessary data. The department's oversight has been deficient because there has been so little clear guidance to the counties about reporting information critical to making good loan decisions. As a result, the department cannot be sure it is making prudent decisions in awarding loans. Further, to the extent that counties do not report sufficient data, the department cannot be sure they are using the loan funds for property tax administration and that the counties invest the appropriate share of county resources in these efforts.

We recommended that the department improve its oversight by requiring that counties use a standard process for reporting incremental accomplishments, revenues, and expenditures related to loan funds, including evidence to demonstrate an appropriate county investment of resources in property tax administration. In addition, the loan agreements with the counties should specify how these are calculated.

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

The department states it has developed and now uses a standard worksheet to identify additional accomplishments and revenues the counties receive due to loan funds. In addition, the department requires a standard process for reporting the actual expenditures of loan funds. However, it does not require the counties to provide evidence to demonstrate appropriate county investments of local resources in property tax administration. Also, the department does not require the loan agreements with counties to specify how incremental accomplishments, revenues, and expenditures related to loan funds are calculated. In its 60-day response, the department indicated that it would recommend statutory changes to include our remaining recommendations if legislation to extend the program was proposed. Since that time, the Legislature extended the loan program through the 2001–02 fiscal year with the enactment of Chapter 602, Statutes of 2000. However, the department has not yet made efforts to implement these remaining recommendations.

Finding #2: County-reported data are insufficient and unverified.

Information that counties report is not always sufficient to determine workloads accomplished and revenues generated with the loan money. In particular, we found that 9 of the 47 counties in the program reported total rather than incremental workload and revenue data, thus obscuring the accomplishments funded via state loans.

Additionally, the department awards loans to counties based on unverified information. Agreements with counties do not require county auditors to verify the county's use of loan funds and its compliance with maintenance of effort requirements.

To ensure the department is receiving accurate and reliable information from the counties, we recommended that it require each county auditor to validate, according to the agreement language,

the following: incremental accomplishments, revenues, and expenditures resulting from loan funds; the amount of county revenues spent on property tax administration; and the amount of unused loan funds from prior years and how the county used those funds.

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

The department responded that the nine counties we identified above are now either reporting incremental accomplishments and revenues or are using the methodology identified in our report to determine the incremental increase in property tax revenues as a result of the loan. Also, the department stated that county auditors are now providing validation of the revenues derived from the loan funds in addition to the accomplishments achieved by the loan recipients. However, the department has not ensured that loan agreements with counties require county auditors to validate expenditures of loan funds, the amount of county money spent on property tax administration, the amount of unused loan funds from prior years, and how the funds were spent. As stated above, the department committed to make efforts to implement our remaining recommendations if the loan program was extended. Chapter 602, Statutes of 2000, extended the loan program through the 2001–02 fiscal year, but the department has yet to implement these remaining recommendations.

Finding #3: The department loses track of unspent funds.

Some counties carry over loan funds unspent in one loan period to succeeding loan periods. When counties do this without explaining how and when they plan to spend the excess, the department jeopardizes its ability to determine that loan funds ultimately are spent on property tax administration. In addition, carrying over funds suggests that the department's awards are larger than necessary.

To ensure that counties use loan funds only for property tax administration and that reported revenues are attributable to loan funds actually spent, we recommended that the department require the counties to explain how they plan to use any excess loan funds, report the actual amount of loan funds they spent during the loan period, and calculate additional revenues generated from their actual use of loan funds using one of the acceptable methods described in our report.

Department Action: Corrective action taken.

The department now requires counties to identify if they have any carry-over funds, the amount of those funds, and to explain how they plan to use them. After the funds are used, the department also requires that counties report how the funds were actually spent.

DEPARTMENT OF HEALTH SERVICES

A Conflict of Interest Did Not Cause the Fresno District's Inadequate Oversight of Skilled Nursing Facilities

REPORT NUMBER 2000-122, OCTOBER 2000

Audit Highlights . . .

Our review of the Department of Health Services' (department) Licensing and Certification Program's oversight of skilled nursing facilities by its Fresno district office (FDO) disclosed the following:

- ☑ *The department has been slow to follow advice from its legal counsel to expand its conflict-of-interest policies.*
- ☑ *The FDO did not appropriately prioritize complaints or initiate and complete complaint investigations in a timely manner.*
- ☑ *The FDO issued four citations that were too lenient given the severity of the violations.*

We evaluated how the Department of Health Services (department) and its Licensing and Certification Programs' (program) Fresno district office (FDO) ensure that they identify potential conflicts of interest on the part of their employees. We also evaluated whether they prevent any conflicts of interest from resulting in inadequate monitoring of skilled nursing facilities under their jurisdiction.

Finding #1: The department has been slow to implement a comprehensive conflict-of-interest policy as recommended by its legal counsel.

The program's integrity depends on its staff's ability to avoid actual or potential conflicts of interest while performing their monitoring and enforcement duties. It is the department's responsibility to assist program staff in ensuring that employees are not participating in decisions that can result in the appearance of bias. Because department policies applicable to the program do not specifically address the potential for certain types of conflicts of interest among district administrators, the department's legal counsel recommended that the program adopt an impairment policy that would better enable its management staff to avoid these types of conflicts. The department had taken some steps toward developing such a policy and expected to incorporate it into its existing conflict-of-interest policies by the end of 2000. However, as of October 2000, it had not yet done so.

We recommended that the department follow its legal counsel's advice to obtain an opinion from the Fair Political Practices Commission for adopting an impairment policy that will ensure that all employees and managers can readily identify and avoid the appearance of bias and impropriety in their assessments of health care facilities. Further, to ensure that its impairment policy covers financial as well as other types of conflicts of interest that can arise, we recommended that the department also obtain

information from the attorney general regarding conflicts of interest, incorporate it into its impairment policy, and communicate the new policy to its employees.

Department Action: Pending.

The department is continuing work to finalize a Code of Conduct Policy that will provide a complete listing of rules governing conflicts of interest, incompatible activities, and potential for bias. The department will distribute the policy to all program staff when it is finalized.

Finding #2: The FDO administrator was part of an enforcement action against a skilled nursing facility that is owned by a company that also owns the facility in which her parents reside.

In October 1998 the department's legal counsel advised the program to separate the administrator from all decisions involving four skilled nursing facilities owned by the company. This was done by assigning another supervisor to act as district administrator in all matters regarding those facilities. For the most part, the administrator followed the legal counsel's advice and removed herself from decisions involving the four facilities by delegating oversight of monitoring activities to a senior FDO supervisor. Still, after she had announced that she delegated this responsibility, the administrator reviewed a draft of a citation issued in April 2000 to one of the company's facilities.

We recommended that to ensure that no perception of a conflict of interest arises, the FDO administrator should not participate in or review any district office activities related to skilled nursing facilities owned by the company.

Department Action: Corrective action taken.

The department transferred the review and decision responsibility for the skilled nursing facilities owned by the company to the manager of the San Bernardino District Office on June 6, 2000.

Finding #3: The FDO did not appropriately prioritize several complaints and failed to initiate investigations promptly.

In our review, we found that the FDO misidentified 3 complaints as priority 2 rather than priority 1 and failed to initiate investigations for 2 of these within the required 2-day time period. In addition, the FDO failed to initiate investigations for 21 of

52 priority 2 complaints within the required 10-day time period. For example, the FDO was 60 days late in beginning an investigation of an instance in which a resident's death may have been caused by staff error and 43 days late in beginning an investigation of a situation in which a resident may have been abused by facility staff.

The program's lack of guidance may contribute to the FDO's misidentifying priority 1 complaints. The program's procedures manual includes a chart with the required response time frame for the two complaint priorities. The manual additionally defines the priority levels and provides a list of issues, such as physical and verbal abuse, inadequate staffing levels, food poisoning, and gross medication errors that constitute an immediate and serious threat. However, the usefulness of the chart and definitions is limited; those individuals assigning priorities to complaints often must rely on their own experiences with other complaints. Including a collection of actual case scenarios in the complaint procedures manual would enable the supervisors to put into context the complaint being reviewed, which could facilitate the more appropriate assigning of priority levels.

We recommended that the department provide more guidance, such as examples of complaints, in its complaints procedures and require program staff to initiate investigations within the required time frames.

Department Action: Corrective action taken.

The department has updated its complaint investigation and citation policies and procedures and has hired additional program staff to decrease response times to complaints regarding resident care. In addition, the department has provided these staff extensive complaint and investigation training to ensure rapid response to complaints.

Finding #4: The FDO did not complete all investigations in a timely manner.

The department's program requires district office staff to complete an investigation within 40 working days from the receipt of a complaint. We found that for 6 of 64 complaints we reviewed, the FDO took considerably longer than the permitted 40 days. For example, it took the FDO 89 days to complete an investigation involving patient abuse.

We recommended that the department require program staff to complete complaint investigations within the required time frames.

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

The department has now fully staffed the FDO. However, it did not report whether the FDO is now completing its complaint investigations within the required time frames.

Finding #5: In four instances, the FDO issued inappropriately low citations.

The Health and Safety Code define three levels of citations—class AA, class A, and class B—with class AA issued for the most severe violations. However, the FDO did not issue an appropriately severe citation for 4 of the 19 citations we reviewed. Two top managers at the program's central office in Sacramento reviewed the citations and agreed with our conclusions. For example, the FDO issued a class B citation when it found that the nursing staff at a facility administered five medications that reduce blood pressure to a resident without properly monitoring her vital signs and without notifying the attending physician when the resident showed signs of adverse reactions. The severity of the violation called for a class A citation; however, neither the evaluator who investigated this complaint nor the supervisor who reviewed the citation consulted a medical expert for another opinion. Although the department's program does not require its district offices to consult medical experts for class B citations, the FDO is not using its maximum enforcement authority when it fails to seek the opinions of program experts if a decision regarding the suitability of a citation level is unclear.

We recommended that the department require program staff to seek opinions from medical consultants, legal consultants, or other experts from its field operations branch when in doubt about the level of citation.

We also recommended that to ensure that the program's performance is consistently high throughout the State, the department should review the complaint and citation practices at each of its program's district offices and provide additional training, if necessary.

Department Action: Corrective action taken.

The department provided extensive training on citations to all of its program's surveyors in June 2000. The department has also clarified various issues pertaining to citations in a memo to all district managers and administrators. The memo included examples of appropriate documentation of the reasons for determining penalty amounts. To ensure accurate assessment of citation levels and penalty amounts, the department now requires all class A and class AA citations to be reviewed by its regional field operations branch chiefs, its office of legal services, and its medical or other consultants as appropriate. In addition, the department will require its programs' branch chiefs to review some of the class B citations.

DEPARTMENT OF HEALTH SERVICES

Additional Improvements Are Needed to Ensure Children Are Adequately Protected From Lead Poisoning

REPORT NUMBER 2000-013, MAY 2001

Audit Highlights . . .

Our follow-up audit of the Childhood Lead Poisoning Prevention Program (program) revealed that the Department of Health Services (department) made only limited progress in implementing our recommendations. As a result, the department still:

- ☑ *Does not ensure California's children identified with lead poisoning receive the proper medical care and are protected from further exposure.*
- ☑ *Is unable to determine the full extent of lead poisoning in California—having identified only about 10 percent of the estimated 38,000 children needing services.*
- ☑ *Lacks the enforcement authority needed to reduce or eliminate lead hazards.*

Additionally, the department needs to address staffing shortages and projected funding shortfalls to avoid potential cutbacks in program operations.

As early as 1986, the Legislature charged the Department of Health Services (department) with determining the extent of lead poisoning among children in the State. In 1991 the Legislature set specific goals for protecting children from lead poisoning: it asked the department to evaluate all children for their risk of poisoning; to test those children who were at risk; to provide case management for children who were at risk; and to provide case management for children who were found to suffer from lead poisoning.

Chapter 540, Statutes of 2000, requires the Bureau of State Audits to report on the extent to which the department has addressed the recommendations made in our April 1999 report. Our follow-up audit of the department's Childhood Lead Poisoning Prevention Program (program) concluded that the department still has made only limited progress in fulfilling its most critical missions related to lead poisoning and has not fully implemented all of our previous recommendations. Specifically:

Finding #1: The department does not ensure that local programs follow its case management process.

The department has failed to enforce case management guidelines for local programs that require them to report all their activities for lead-poisoned children. Additionally, when the required reports are submitted, the department does not review them to ensure adequate services are rendered to children. Without obtaining and reviewing case management information, the department cannot be certain that all lead-poisoned children receive proper care, that the levels of lead in their blood are reduced to safe levels, or that the sources of their lead exposure are reduced or eliminated.

We recommended that the department ensures that local programs submit all case management information outlining the services provided to lead-poisoned children, and monitor local programs' activities to ascertain whether lead-poisoned children receive appropriate care.

Department Action: Corrective action taken.

The department stated that it instituted protocols designed to monitor case management by local programs. The protocols include a review of all follow-up forms submitted by local programs as well as a detailed review of a sample of all forms. The reviews are designed to ensure that all follow-up information on lead-poisoned children is submitted promptly and that the information is complete. Further, the branch has conducted site reviews of local health departments. Although some deficiencies have been noted during the reviews and issues requiring additional guidance and training have been identified, the department reports that most local programs are doing an excellent job. Finally, the department reported that it is revising its follow-up forms and tracking database to improve the tracking of case dispositions.

Finding #2: The department has not determined where and to what extent lead poisoning is a problem throughout the State and has not adequately identified children with lead poisoning.

The department has not been successful in its efforts to implement regulations that would require laboratories to report the results of all blood-lead tests. Efficient reporting of all blood-lead tests and their results would provide the department the data it needs to evaluate and report on the nature and extent of lead poisoning among California's children. Implementing these regulations is also critical because current blood-lead reporting requirements do not correspond with the department's more restrictive criteria for providing case management. As a result, the department cannot ensure that all children requiring case management receive these services.

To collect data on where and to what extent lead poisoning is a problem and to ensure that children with elevated blood-lead levels are identified and treated, we recommended that the department adopt regulations requiring laboratories to report all blood-lead test results and complete the testing and installation of software that will allow laboratories to electronically submit their results.

Department Action: Partial corrective action taken.

The department has not adopted regulations requiring labs to report all blood-lead test results. Its proposed regulations to accomplish this are currently being reviewed by the Department of Finance. The department also has not completed the testing and installation of software that will allow laboratories to electronically submit their blood-lead test results. However, the department reported that it continues to recruit labs to voluntarily report all blood-lead test to the State and estimated that it is receiving approximately 50 percent of all tests performed on California children.

Finding #3: The department still needs to design enforcement and evaluation components for statewide screening requirements.

Although the department has substantially complied with state law and the United States Centers for Disease Control and Prevention's guidance in enacting its screening requirements, it has not incorporated measures to ensure these requirements are effective.

To improve the effectiveness of its screening regulations and state plan, we recommended that the department revise its screening regulations to add an enforcement component and to require all providers to document their reasons for not ordering blood-lead tests on children. We also recommended the department develop a plan to monitor and evaluate its screening regulations and statewide targeted screening policy.

Department Action: Corrective action taken.

The department reported that its revised screening regulations became effective November 19, 2001. In its efforts to monitor compliance with these regulations, the department stated that it has produced several pilot reports from the Medi-Cal Managed Care Information System and is in the process of validating the report data. Once complete, the department plans to analyze screening coverage in targeted groups and to identify providers who have poor screening rates. The department also reported that it is conducting an annual evaluation of 300 patient screening charts at each Medi-Cal Managed Care Plan to assess their lead screening performance. Moreover, the department is working with Child Health and Disability Prevention (CHDP) providers to obtain screening data from their information

systems. Once it implements its universal reporting regulations, the department plans to use the data to validate data from Medi-Cal and CHDP.

Finding #4: The department does not identify and educate Medi-Cal or CHDP providers who fail to screen children for lead poisoning.

Although the department has taken steps to educate providers of the need to screen high-risk children for lead poisoning, it has been unable to target its educational efforts to those providers who are not ordering blood-lead tests. Both the State and federal government require that all children receiving Medi-Cal and CHDP services receive a blood-lead test; however, less than 25 percent are tested.

To improve the effectiveness of its outreach efforts, we recommended that the department target those providers who fail to comply with the screening requirements.

➲ ***Department Action: None.***

The department reported that it has taken no action to improve the effectiveness of its outreach efforts by identifying and educating Medi-Cal and CHDP providers who fail to screen children for lead poisoning. However, it reports that it has increased the reimbursement to all Medi-Cal and CHDP providers for blood tests and counseling as an incentive to increase screening rates.

Finding #5: Ongoing staffing shortages and lawsuits as well as projected funding shortfalls threaten the department's current level of program operations and its ability to make needed improvements.

The department's progress in protecting California's children from lead poisoning has been hindered by the lack of adequate staff and by lawsuits that divert the attention of the staff it does have away from its primary mission. Of equal concern, without an infusion of funding, the department is projecting a funding shortfall for the program in fiscal year 2003–04 that would likely result in cutbacks in activities, which are already insufficient.

To ensure that the program is able to adequately protect California's children from lead poisoning, we recommended that the department take the steps necessary to ensure that the program has adequate funding and staffing to achieve its mandates and goals.

Department Action: Pending.

The department reported that it is looking at possible options that will ensure adequate funding for the lead poisoning program.

Finding #6: The lack of explicit enforcement authority limits state and local efforts to reduce or eliminate sources of childhood lead exposure.

Although the department has conducted numerous training sessions to educate local officials about ways to use existing laws to order and enforce the reduction or elimination of lead hazards, it has been unsuccessful in its efforts to have legislation enacted to strengthen statewide authority in these areas. As a result, local officials and the department may be unable to adequately protect children from lead hazards.

We recommended that the department seek legislation granting the department, cities, and counties the authority to investigate properties with suspected lead hazards and to order and enforce the abatement of lead hazards against property owners. In the absence of this authority, the department should continue its efforts to assist local authorities with issuing and enforcing abatement orders by continuing its training and education efforts.

Department Action: Partial corrective action taken.

The department states that if AB 422, 2001–02 Session, is enacted, it will make explicit the authority of both state and local agencies to order and enforce abatement of lead hazards. In the interim, the department reported that it has developed a draft enforcement guidance manual for local agencies and will continue conducting training classes for local programs.

Finding #7: The department remains at risk of losing federal funding for lead hazard reduction and elimination activities.

The department has been unsuccessful in enacting regulations granting it the authority to impose administrative, civil, and criminal sanctions against those who violate state requirements related to lead-safe work practices. As a result, the department has failed

to comply with the requirements of the Federal Environmental Protection Agency. Until the department addresses these issues, it places the State and local agencies at risk of losing federal funding to support lead reduction or elimination activities.

We recommended that the department seek legislation granting enforcement authority to impose administrative, civil, and criminal sanctions against those violating lead-safe work requirements.

Department Action: Pending.

The department reported that it is working on options that will allow it to impose sanctions for noncompliance with lead-safe work practices and certification requirements.

Finding #8: The department has yet to complete a statewide plan for its health care provider outreach efforts.

In 1996 the department began developing a statewide provider outreach plan to educate providers on the importance of evaluating and testing children for lead poisoning. Although the department has begun to implement some of its provisions, the plan is still in draft and lacks timelines and implementation strategies the department will need to evaluate whether its activities are on target and effective in reaching and educating providers.

We recommended that the department continue its efforts in finalizing and implementing a comprehensive statewide provider outreach plan complete with timelines and implementation strategies.

Department Action: Corrective action taken.

The department stated that the plan is completed and that implementation efforts are underway. Its outreach activities include new outreach materials, Web site accessible information, a media campaign, and provider notification.

Finding #9: It is too soon to tell whether the department's requirement for local programs to monitor their outreach and education efforts is successful.

The department now requires local programs to evaluate the effectiveness of their outreach and education efforts in identifying more lead-poisoned children, and it also provides assistance to local programs in developing the proper tools to complete these efforts. However, full implementation and evaluation of these efforts are to occur over a two-year period ending June 30, 2002. These

efforts will allow the department to determine which outreach strategies achieve the best results and to share the knowledge with local programs.

We recommended that the department continue its efforts to assist in refining the tools that are currently in place for evaluating the effectiveness of the local programs' outreach and education efforts.

Department Action: Partial corrective action taken.

The department has received and reviewed the first and second biannual progress reports from local lead poisoning programs. The department states that it created a database to track and analyze the information in the progress reports.

Finding #10: The department developed a comprehensive lead-safe schools program; however, it may not have the funding to fully implement the program.

In response to a department study that found many schools and day care facilities have lead-based paint or lead in their water, the department developed a curriculum to educate schools and day care staff on the appropriate steps for reducing or eliminating lead hazards. Although it has conducted training at slightly more than half of the school districts targeted for having elementary schools, it will be unable to complete its training efforts before its funding expires.

We recommended that the department pursue the funding needed to complete its lead-safe schools training program in all targeted school districts and to provide follow-up training to these schools as necessary.

Department Action: Corrective action taken.

The department states that it is continuing to fund the lead-safe schools program and is renewing its contract to create instructional materials and train school district representatives about lead hazards. The department is also working on finalizing an evaluation report on the program.

DEPARTMENT OF HEALTH SERVICES

Drug Treatment Authorization Requests Continue to Increase

REPORT NUMBER 2000-009, AUGUST 2000

Audit Highlights . . .

Our audit of the Department of Health Services' (department) processing of drug treatment authorization requests (TARs) disclosed:

- ☑ *The number of TARs received and processed continues to increase.*
- ☑ *The average month-end backlog of unprocessed TARs was 11.6 percent for the current 24-month review period.*
- ☑ *The department was unable to fully process 615 of the 2,711 drug TARs we sampled within one workday, as required. However, for 249 of these TARs, the provider had access to the department's decisions within one working day.*
- ☑ *Processing is slow because of staffing problems and because the department's contract with Electronic Data Systems does not require TAR's processing in the time period required by department policy.*

The Government Code and the Welfare and Institutions Code required the Bureau of State Audits (bureau) to prepare an analysis and summary of the Department of Health Services' (department) data on drug treatment authorization requests (TARs) and submit a report to the Legislature beginning February 1, 1991, and every six months thereafter until January 1, 1999. New legislation in 1999 extended this requirement to January 1, 2001. This is our most recent and final report, covering four six-month intervals from June 1998 through May 2000. In summary we reported the following:

- The department did not always comply with the state policy by taking longer than one working day to fully process 615 TARs (22.7 percent) of the 2,711 drug TARs we sampled that were either faxed or mailed. Of the 615 TARs, the decisions on 366 were not available within one workday. The Stockton drug unit took two to three working days to fully process 591 of the drug TARs faxed to it. For 366 of these drug TARs, 13 percent of our sample, the decisions were not available to providers within one working day. The Los Angeles drug unit also took two to five working days to fully process 24 of the drug TARs mailed to it. However, for all 24, the consultants' decisions were available to the drug providers within one working day.

- The department received 659,328 drug TARs from December 1999 through May 2000, an increase of 580,830 (740 percent) over that of our first six-month review period 10 years ago. This increase is due to the fact that, in November 1994, the law reduced the limit of prescriptions from 10 to 6 per month that an individual beneficiary could receive before a drug TAR had to be submitted. In addition, although the number of Medi-Cal beneficiaries has decreased from its high point in 1995, the number is still higher than during the first review period. Moreover, beneficiaries with more severe illnesses remain with Medi-Cal instead of transferring to managed care, which does not require the TARs. Also, there is a trend toward giving medication and care outside of a hospital setting.

- From December 1999 through May 2000, the department received 154,684 (30.7 percent) more drug TARs than it did during our previous review period of December 1997 through May 1998. However, compared to the previous review period, the number of eligible Medi-Cal beneficiaries declined by 8.7 percent during December 1999 through May 2000.

- Drug providers continue to submit most drug TARs by fax. From June 1998 through May 2000, drug providers faxed to the department 98.9 percent of all drug TARs. The department received 158,169 more drug TARs by fax from December 1999 through May 2000, an increase of 32 percent over our previous review period of December 1997 through May 1998.

- The department processed 662,288 drug TARs from December 1999 through May 2000, an increase of 585,006 (757 percent) over the number processed during our first six-month review period 10 years ago. This increase is directly related to the increase in the number of drug TARs received.

- From June 1998 through May 2000, the average percentage of unprocessed drug TARs during each six-month interval has ranged from 10.1 percent to 13.2 percent. These percentages—while lower than the high of 34 percent during December 1991 through May 1992—are significantly higher than the 1.6 percent of unprocessed TARs during June 1995 through November 1995. The average month-end backlog of 11.6 percent for the current 24-month review period does not vary greatly from the 11.9 percent reported during our previous review.

- The department's current policy to process drug TARs within one working day is less strict than the federal requirement to process drug TARs within 24 hours. However, the federal government acknowledges that processing time can exceed 24 hours and allows the department to exceed the federally mandated processing time requirement as long as emergency drugs are available to beneficiaries when necessary. The department adheres to this condition by not requiring a drug TAR for emergency situations.

- Beneficiaries submitted 705 fair hearing requests during our current 24-month review period of June 1998 through May 2000. Of these requests, 545 were withdrawn or dismissed, 50 were denied, and the decision on 9 were still pending at the time of our review.

- The department has not fully implemented all recommendations in our last report, which was issued in August 1998. The department has not closely monitored the staffing of data-entry personnel, been able to negotiate a new contract with a turnaround time for drug TARs of one working day, and reinstated procedures for monitoring processing times. The department, however, has developed a system to address problems with computer and data-transmission equipment.

We recommended that the department should take the following steps to ensure it is promptly processing drug TARs:

- Continue to more closely monitor the scheduling of data-entry staff to ensure that the department can process within the required time frame the estimated number of drug TARs it will receive.

- When the current contract with Electronic Data Systems expires, negotiate a new contract with a turnaround time for drug TARs of one workday.

- Ensure that its new system includes comprehensive procedures for monitoring processing times.

Department Action: Partial corrective action taken.

The department continues to report that it closely monitors and adjusts the number of data-entry personnel. It requires all Medi-Cal field offices to immediately report significant changes in TAR receipts to headquarters so that required adjustments in data-entry staff may be made to prevent increases in backlogged TARs due to insufficient staffing. The department also states that its new contract will require TAR processing turnaround time consistent with federal law and the department's own policy.

In addition, the department continues with its efforts to redesign its TAR system. The redesigned TAR system will feature an Internet-based on-line TAR submission and adjudication. The department expects that the new system will shorten TARs processing times and substantially reduce the amount of paper documents. The department states that the new system will allow comprehensive monitoring of TARs processing.

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Poor Administration of Certain Aspects of the California Natural Disaster Assistance Program for Loma Prieta Earthquake Victims Could Result in Inappropriate Loan Forgiveness

Audit Highlights . . .

We reviewed California Natural Disaster Assistance Program (CALDAP) loans provided to victims of the Loma Prieta earthquake by the Department of Housing and Community Development (department) and found that:

- ☑ *Despite borrower allegations concerning the quality of repair work, state and local jurisdictions generally provided adequate oversight.*
- ☑ *The processes used by some jurisdictions may have caused a few borrowers to believe they were not allowed to select their own contractors.*
- ☑ *By not sending periodic loan statements, the department may have contributed to some borrowers' confusion regarding their loans.*
- ☑ *The department has not been diligent in monitoring compliance with forgiveness requirements, thereby increasing the risk that some part of $15.6 million in loans will be inappropriately forgiven.*

REPORT NUMBER 2000-129, MAY 2001

The Joint Legislative Audit Committee requested that we review the Department of Housing and Community Development's (department) administration of its California Natural Disaster Assistance Program (CALDAP) for victims of the Loma Prieta earthquake. After the earthquake in October 1989, the department loaned approximately $87 million to more than 900 borrowers to repair and rehabilitate damaged or destroyed single-family dwellings and rental housing. We found that:

Finding #1: Despite complaints concerning the quality of repair work, state and local jurisdictions generally provided adequate oversight.

The CALDAP homeowner loan program provided loans to homeowners in need of assistance. However, nearly 45 percent of the homeowner borrowers in Berkeley and Oakland have alleged various problems. Some of the complaints date to the early 1990s when the repair work was completed, and relate mostly to poor workmanship by contractors. We found that the validity of these complaints varied. For instance, some borrowers have stated that the work performed on their homes was unsatisfactory or incomplete, and some said that rehabilitation inspectors did not appropriately perform their jobs. In fact, a few homeowners have succeeded in recovering damages from contractors through legal action. However, based on the available documentation, we found that for the most part, the local agencies administering CALDAP had adequately overseen repairs and inspections.

In an effort to assess the complaints of poor workmanship, Oakland's Community and Economic Development Agency and Berkeley's City Manager's Office have performed recent inspections

of some of the properties in their jurisdictions. Although these inspections have found that many of the complaints are not related to the original CALDAP repair work, some of the complaints have merit.

We recommended that the cities of Berkeley and Oakland continue to provide a process to investigate and evaluate the complaints of CALDAP borrowers.

Department Action: Partial corrective action taken.

The Berkeley City Council approved a resolution on October 9, 2001, accepting the city manager's recommendations for improvements to city processes related to housing loan programs. In addition, the resolution requested that, among other tasks, the city manager (1) work with the State to forgive the portion of the CALDAP homeowners loans associated with rental units; (2) consult with various government contacts to identify a source of funding for grants to correct housing deficiencies in the CALDAP homeowner loan properties; (3) work with the State to reduce the loan balances by the amount paid by individuals above and beyond the CALDAP loan amount to correct work that was incomplete or improperly done, or work that was caused by work that was incomplete or improperly done; (4) work with the State so that each CALDAP property owner who has any loan remaining at the close of the process will have in writing on an annual basis the amount they owe, how they can repay their loan, or the accumulation of interest on a deferred loan; and (5) work with the State to extend loan repayments beyond six months upon the death of a property owner to allow the heirs of the deceased property owner the option of staying in the home.

➲ ***The City of Oakland has not provided an updated response.***

Finding #2: Some borrowers felt limited by the contractor selection process.

A number of borrowers have alleged that they were not allowed to choose the contractors who worked on their homes. We found that the contractor selection processes varied among the local jurisdictions we contacted. Some jurisdictions involved potential borrowers in the contractor selection process more effectively than others. The seemingly restrictive selection process used by some

jurisdictions may have resulted in a few borrowers believing that they had to use a specific contractor or were not allowed to select their own. However, we did not find any documentation in loan files to support borrowers' allegations that they were directed to select particular contractors.

To ensure that future loan programs better achieve their goals, we recommended that the department reassess its guidelines and standards of operation for local jurisdictions in areas such as contractor selection and oversight of work quality.

Department Action: Corrective action taken.

In its initial response to the report, the department agreed that the program design of CALDAP had shortcomings. It also noted that it has not used this program design in its more recent programs.

Finding #3: The department does not provide periodic loan statements.

The department may have contributed to some borrowers' confusion regarding their CALDAP homeowner loans by not sending periodic loan statements. Except for a statement of final indebtedness following the payment of all anticipated CALDAP rehabilitation expenses, the department has not provided borrowers with periodic statements of their increasing total indebtedness as interest accrues on their loans. Consequently, some borrowers believed their loans were actually grants while others did not fully understand loan repayment terms or refinancing restrictions.

We recommended that the department provide periodic loan statements to borrowers that include outstanding principal and interest amounts and specific contact information for borrowers with questions.

Department Action: Partial corrective action taken.

The department reported that it is prepared to send annual loan balance statements to CALDAP borrowers beginning in January 2002. In addition, the department sent letters to all borrowers on June 12, 2001, reminding the borrower of the CALDAP loan and providing information related to department contacts.

Finding #4: Repayment terms of CALDAP loans may cause hardship for the heirs of some low-income borrowers.

Some provisions of the CALDAP owner loans may result in difficult repayment situations for the heirs of a small portion of the program's borrowers. The terms of CALDAP homeowner loans specify that loan repayment is not required until ownership of the repaired property is transferred or the property is no longer the borrower's principal place of residence. For example, when a borrower dies, California law and the terms of the promissory note prohibit the loan from being assumed except by the surviving spouse, which means that any other heir must repay or refinance the loan to inherit the property. However, in some cases, the heirs may not have sufficient financial assets to repay or refinance the loan. If, for instance, the heirs are disabled or dependent adults, the department should have a method to determine, on a case-by-case basis, the action it believes is in the best interest of the State.

We recommended that the department review and evaluate its existing policies addressing the repayment of homeowner loans to ensure that its policies adequately address difficult repayment situations. If the department determines that a revision of these policies or procedures is, in certain limited circumstances, in the State's interest, it should pursue a statutory revision to allow it the needed operational flexibility.

Department Action: Corrective action taken.

The department reported that it has developed guidelines for decisions regarding forbearance on the foreclosure or other enforcement of CALDAP loans to maximize repayment of public funding while avoiding undue hardships. Because CALDAP operates under guidelines, the department did not undertake revisions to any of its statutes. The department also indicated that its current policy is for departmental management to review decisions to forebear and these decisions are documented in each loan file.

Finding #5: The department's monitoring of CALDAP rental loans has been lacking.

The CALDAP rental loan program assists owners and tenants of rental properties. For this reason, CALDAP rental loan borrowers are required to comply with certain rent restrictions, and if these borrowers also restrict units to low-income tenants for at least 10 years of their loans, the State will forgive the rehabilitation portion of their loans. Yet the department did not establish a process

to monitor its rental loan borrowers until mid-1996, 4 years after most of the rehabilitation work had been completed. This delay was despite the statutory requirement that borrowers requesting loan forgiveness comply annually with specific performance conditions for rent and tenant-income levels. Moreover, the department has not always enforced consistent minimum levels of compliance. In addition, the department's guidelines require that assisted units of properties with refinancing loans comply with rent restrictions for the entire length of the original loan. However, we found two loans during our review where funds were used for refinancing but that the department is not monitoring to ensure compliance with the required rent restrictions. Thus, low-income tenants in those facilities for which the owners had opted for forgiveness had no assurance that they were provided the low-cost housing mandated in the statutes.

Further, the department has not been sufficiently diligent since it began monitoring compliance with the terms of rehabilitation loans in 1996, thereby increasing the risk that some part of the $15.6 million in eligible loans may be forgiven even though some borrowers may not have complied with the required terms. The department has not maintained sufficient documents in its files to verify compliance, and supporting data from loan files has not always agreed with the summary records that the staff prepares and provides to the program's managers.

We also found that the department incorrectly applied maximum allowable rent rates. Moreover, the department has classified some borrowers as conditionally compliant despite the fact that they left units vacant for years at a time or charged rents in excess of the maximum allowable. However, in these cases, it is unclear whether the department will require the borrowers to repay a portion of their loans for the noncompliant years. By granting these borrowers greater latitude than statutory provisions allow, the department may ultimately forgive portions of loans that are not eligible for forgiveness.

To strengthen the process by which it monitors borrowers with rental loans, we recommended that the department take the following steps:

- Ensure that minimum levels of compliance are specified in writing and are sufficiently detailed in accordance with underlying statutes and guidelines.

- Monitor all applicable borrowers—both those that are pursuing loan forgiveness and those that received funds for acquiring property or refinancing—to ensure they meet the terms and conditions of their Regulatory Agreements.

- Retain documents such as periodic status letters, correspondence, and borrower disclosure information of rent and tenant-income levels in borrowers' files to verify compliance with loan forgiveness conditions.

- Provide sufficient annual feedback to allow monitored facilities to correct noncompliant activities. The department should allow conditional certifications only when borrowers agree to correct noncompliance, such as by refunding tenants' overpayment of rents.

- Ensure that future calculations of maximum allowable rent are applied in the appropriate year. The department should also establish status tracking work sheets for all borrowers with rental loans pursuing forgiveness and borrowers with acquisition or refinancing loans.

Department Action: Partial corrective action taken.

The department reported the following status of its implementation of the recommendations:

- By May 1, 2002, the department intends to update its CALDAP desk manual to provide staff with more thorough detail regarding acceptable minimum levels of compliance.

- The department has identified the type of monitoring required by all loans in its CALDAP portfolio. On October 26, 2001, the department sent letters to borrowers of all three types of CALDAP rental loans restating their obligations to maintain rents and occupancy in accordance with their regulatory agreements. The letters also indicate that these forms and certifications will be sent annually and borrower response will be necessary to ensure that the loan remains in good standing.

- The department has developed policies concerning the term of affordability required to qualify for loan forgiveness. After the policies were documented, the department's legal affairs division reviewed them for consistency with CALDAP and approved them. The department believes this approach provides clearer legal guidance than does a legal opinion.

- The department's program managers have issued written instructions to staff concerning the retention of correspondence and documents in the borrower files.

- The department has adopted loan forgiveness policies and procedures, which include a resolution process of noncompliance issues. On or before May 1, 2002, and annually after that, the department will provide a certification letter to all borrowers who are seeking loan forgiveness.

- The department has adopted a policy entitled "Calculation of CPI Rate of Increase," which will be applicable to CALDAP rental loan program rents. In part, the policy provides (1) after one year of initial occupancy, and annually thereafter, the rents for the assisted units may be increased by the borrower at a rate not to exceed the most recently published annual average percentage change in the U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index, Rent Residential for all Urban Consumers for the West (CPI); and (2) borrowers may appeal to the department for a greater adjustment in rents, if necessary, to ensure the fiscal integrity of the rental housing development. In addition, CALDAP program staff have determined that the department's computer database is capable of incorporating loan forgiveness data fields as well as data fields to record information about borrowers with acquisition or refinancing loans. These necessary enhancements are included in the department's annual work plan and will be implemented during fiscal year 2001–02. Meanwhile, electronic spreadsheets, which facilitate the submittal of operating budgets and rent increase requests, of another of the department's loan programs will be made available to CALDAP borrowers and management agents by December 30, 2001.

DEPARTMENT OF INSURANCE

Recent Settlement and Enforcement Practices Raise Serious Concerns About Its Regulation of Insurance Companies

REPORT NUMBER 2000-123, OCTOBER 2000

Audit Highlights . . .

Our review of the settlement practices at the Department of Insurance (department) revealed that:

- ☑ *The former commissioner abused his authority by requiring companies to make "off-the-book" payments directly to third parties that were unrelated to the enforcement activities that led to the payments.*
- ☑ *Other settlement payments made directly to third parties, while apparently legal, were imprudent because they were not subject to state purchasing and expenditure controls.*
- ☑ *Many settlements failed to include any monetary penalties against insurance companies that violated the law.*

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The Joint Legislative Audit Committee (audit committee) asked us to determine the number of settlement agreements the Department of Insurance (department) reached with insurers between January 1996 and the end of May 2000. The audit committee also asked us to track payments ordered by the settlement agreements to determine if and when insurers made such payments. Finally, we evaluated the department's record keeping to determine whether it is adequate to ensure appropriate and prompt payment of settlement agreements.

Finding #1: The former insurance commissioner abused his discretionary authority in the settlement of enforcement actions.

Between January 1, 1996, and May 31, 2000, the former commissioner entered into 96 settlement agreements requiring some form of monetary payment on the part of the insurance companies for various violations of the insurance code. However, the former insurance commissioner abused his authority by requiring insurance companies to make $12.3 million in outreach payments directly to vendors and nonprofit organizations when such payments did not relate to the regulatory activities that gave rise to them. These funds were not subject to the State's system of fiscal controls and were outside the Legislature's oversight. According to an attorney general's opinion, to be legal, an outreach payment to a third party must be related to the enforcement responsibilities of the department that led to the settlement agreement.

The department also omitted critical enforcement provisions from settlement agreements—such as the levying of fines and issuance of cease and desist orders when insurance companies engaged in unfair or deceptive business practices. Failure to assess penalties or ordering insurers to cease unfair or deceptive practices misleads the public and gives the appearance that no improper conduct occurred while precluding the department from using stronger

☑ *The department deprived consumers of important information regarding insurance companies because settlement agreements omitted details of the insurers' illegal activities.*

☑ *Insurers that violate the law may go unpunished because the department does not effectively manage its enforcement activities.*

sanctions in the future if the insurer violated the same sections of law. In lieu of assessing penalties, the department required insurers to make outreach payments directly to third parties. In fact, the amount of outreach payments required of insurers generally increased in proportion to the amount of fines and penalties assessed to insurers during the 4.5-year period we examined.

Even when the department does impose a fine or penalty on an insurance company that violates the Insurance Code, it fails to consistently report such actions to the National Association of Insurance Commissioners (NAIC)—a voluntary association created to coordinate the regulation of multistate insurers. Between January 1, 1996, and May 31, 2000, we identified 78 settlement agreements that included fines or penalties. However, the department reported just four such cases to the NAIC. By failing to consistently report the fines and penalties it does impose, the department removes an effective deterrent against future violations.

Additionally, the department sometimes masked the purpose of outreach payments by omitting specific information from public settlement agreements. For example, settlement agreements that included an outreach component did not always stipulate the exact amount that was to be paid to the nonprofit organization or vendor. In these cases, the payment amount was specified in a separate letter, which the department agreed to keep confidential.

We recommended that the Legislature consider a change to the Insurance Code forbidding the insurance commissioner from requiring that payments be made to nonprofit organizations, foundations, or vendors as a part of a settlement agreement. We also recommended that the department make penalties a public component of the settlement in all instances involving egregious violations in which a penalty is justified. In addition, the department should include as part of any public settlement agreement the date each type of payment is due, provisions listing the alleged violations, an order to cease and desist from such activities, and any other pertinent terms of the agreement. Finally, we recommended that the department report all penalties assessed against insurers to the NAIC. These actions would ensure the appropriate public disclosure of the nature of the violations and provide the department with more enforcement power should repeat violations occur.

Legislative Action: Corrective action taken.

Chapter 1091, Statutes of 2000 (SB 2107), prohibits the commissioner from ordering an insurer, agent, or broker to make settlement payments to a nonprofit entity, or direct funds outside the state treasury system.

Department Action: Corrective action taken.

The department reported it has implemented a policy whereby standardized language will be used in settlement agreements. Specifically, the language will include the terms of settlements, including monetary amounts to be paid and the time frame within which payment is due. Settlement agreements will also specify the code or regulatory provisions said to have been violated and include, where applicable, cease and desist orders.

The department also stated it has implemented a policy whereby all penalties assessed against insurers will be reported to the NAIC.

Finding #2: The purposes of outreach payments made to entities outside state control were often questionable.

Based on the attorney general's criteria, the settlement terms directing a total of $16.5 million in outreach payments to third parties appear to be legal. However, we believe this practice is imprudent because such payments fall outside the State's fiscal controls. As a result, the subsequent use of these funds can be for questionable purposes.

The Insurance Code requires that the fines and reimbursements the commissioner receives through settlement agreements or by order of an administrative law judge be deposited in the General Fund and Insurance Fund of the state treasury system. Such requirements enable the department to better track insurers' adherence to settlement provisions. In addition, funds deposited in this manner are subject to state purchasing and expenditure controls, and their disbursement must be reviewed and approved according to state laws and regulations. The funds must also be included in the department's budget process, which allows for legislative oversight and public disclosure. Absent these fiscal controls, more than $1.4 million in settlement funds directed to one nonprofit organization were spent for purposes wholly unrelated to the department's regulatory responsibilities.

To ensure that all activities and expenditures funded by settlement payments relate to the department's regulatory responsibilities that prompted the payments and adhere to the State's fiscal controls, we recommended that the department:

- Require insurers to direct all settlement payments to the department.
- Deposit these funds in the state treasury system.
- After depositing such funds, the department could either conduct outreach activities itself or contract for these activities so as to increase its direct control over the expenditures made for outreach and ensure that they clearly relate to the regulatory responsibilities that initiated the payments.

Department Action: Corrective action taken.

The department stated it has instituted a policy that prohibits outreach provisions in settlements with insurers and other regulated entities. The department also reported it has implemented procedures pursuant to SB 2107 that requires the commissioner's approval of settlement terms.

Additionally, the department indicated it has implemented procedures whereby all settlement funds are invoiced by and remitted directly to its accounting bureau. Standardized language has been included in settlement documents that inform licensees that they will be invoiced for penalties and reimbursements and directs them to wait for the invoice before remitting payment. The department's legal branch will provide information to the accounting bureau as to the proper characterization of the monies, and whether the funds should be deposited into the Insurance Fund or General Fund.

The department did not specifically address our recommendation concerning conducting outreach activities itself or contracting out for these activities. However, the changes it addressed in its response sufficiently address our concern over the direct control of expenditures.

Finding #3: The department does not effectively manage its enforcement activities.

Insurers that have committed Insurance Code violations may go unpunished because the department does not effectively manage its enforcement activities. Specifically, the department is unable

to compel insurance companies to correct identified violations promptly because of significant delays by the legal division in resolving cases. For example, according to the legal division's tracking system, as of April 2000, 183 (33 percent) of the 554 open cases in the legal division's compliance bureau have yet to be assigned to an attorney for resolution. Thirty-seven of these cases have been open for more than one year, even though several are designated as high priority. Additionally, bureaus that have initiated enforcement actions cannot quickly determine the status of cases referred to the legal division because the department's systems for monitoring cases are not integrated. We identified at least five separate systems used by the department to track the status of enforcement actions, none of which are capable of sharing information. Finally, poor controls over the remittance of fines, reimbursements for the costs of enforcement activity, and outreach payments do not ensure the prompt receipt and deposit of funds or the appropriate use of settlement payments.

To improve the effectiveness of its enforcement activities, we recommended that the department:

- Develop an integrated system for tracking enforcement activities and establish protocols for the consistent recording of key information.

- Periodically review open enforcement cases and determine why the legal division is taking so long to resolve cases referred to it and correct the situation.

- Instruct insurance companies to remit settlement payments directly to the accounting division or establish cashiering units in the bureaus initiating enforcement actions and the legal division to better safeguard these funds.

- Communicate settlement terms to the accounting division upon approval of settlement agreements so that appropriate accounts receivable can be established to track and monitor payments.

- Strengthen controls in the accounting division to ensure that all settlement payments are collected promptly and deposited in the appropriate state funds.

Department Action: Partial corrective action taken.

The department stated its E-Government and Technology Solution Branch has begun to integrate all enforcement tracking databases within the department. Specifically, it has developed a plan to consolidate its case management systems into one Web-based system. Additionally, the department intends to develop a core information system that will provide case information tracking by pulling data from the consumer services, financial surveillance, and company/criminal investigations management systems. The department's legal branch is also continuing to work toward full implementation of its case tracking system.

Additionally, the legal branch has established a permanent compliance office in Los Angeles. Attorneys are available to the consumer services and market conduct branch and the criminal investigations branch for the purpose of discussing ongoing and proposed investigations and other matters that are currently the subject of administrative proceedings. The department stated it has also instituted monthly meetings of all compliance attorneys to discuss both specific cases and matters of mutual concern regarding consistency and efficiency in the enforcement program.

As previously stated, the department indicated it has implemented new procedures to improve controls over the collection and accounting of proceeds of settlements. Specifically, all settlement funds will be invoiced by and remitted directly to the accounting bureau. Additionally, language will be included in the commissioner's orders informing insurers that they will be invoiced and instructing them to wait for the invoice before remitting payment.

The department has developed a new standard form to be completed by the legal branch, attached to a copy of the settlement agreement, and forwarded to the accounting bureau. The form will characterize any payments to be received as either a fine or cost reimbursement. The form will also indicate whether the funds should be allocated to the General Fund or the Insurance Fund. Finally, the legal branch's database has been modified to provide for the tracking of settlement funds from invoice through final disposition.

DEPARTMENT OF INSURANCE CONSERVATION AND LIQUIDATION OFFICE

Stronger Oversight Is Needed to Properly Safeguard Insurance Companies' Assets

REPORT NUMBER 2001-102, JULY 2001

Audit Highlights . . .

Our review of the operations and internal controls of the Department of Insurance's (department) Conservation and Liquidation Office (CLO) disclosed that the CLO:

- ☑ *Does not adequately safeguard and conserve assets that come under its control.*
- ☑ *Has not updated estate closing plans since 1998, and has never included projected cash flow needs in these plans.*
- ☑ *Does not effectively manage its contracts and its basis for allocating certain costs to insurers' estates is inequitable.*
- ☑ *Has never adopted a comprehensive conflict-of-interest policy for its employees and contractors to follow.*

continued on next page

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to conduct an audit of the operations of the Department of Insurance's (department) Conservation and Liquidation Office (CLO). Specifically, the audit committee asked us to determine whether the CLO has adequate internal controls to detect the mishandling of the assets of conserved and liquidated insurers. The audit committee also asked us to evaluate the sufficiency of the department's efforts to regularly monitor all CLO operations. We found that:

Finding #1: The CLO does not promptly identify and secure all assets of seized or conserved insurers.

The Conservation and Liquidation Office (CLO) does not follow recommended procedures when it inventories the fixed assets of an insurance company (insurer) that it seizes or places in conservation. In a recent example, rather than immediately completing an inventory to identify and safeguard the assets of a seized title insurance company, the CLO waited to do so until at least three weeks after it was authorized to take control of the insurer in February 2000. More recently, the CLO omitted several items from the inventory count of another conserved insurer's fixed assets. In addition, the CLO does not account for all of the assets of liquidated insurers after they are auctioned, so it does not know whether the auction company returns all of the unsold items. Such practices fail to safeguard and conserve the insurer assets that come under the CLO's control.

To ensure that it adequately safeguards the fixed assets of insurers under its control, we recommended that the department see that the CLO take the following steps:

☑ *Spent at least $6 million of insurers' money on a claims processing system that does not meet its needs.*

Additionally, the department has allowed the CLO to continue its poor management practices by failing to properly oversee its activities.

- Develop work plans for each inventory it conducts, based on prudent business practices that include:
  - ♦ Holding preparatory meetings to discuss the inventory process.
  - ♦ Providing instructions regarding how each inventory will be taken.
  - ♦ Promptly conducting inventory counts to reduce the risk of loss.
  - ♦ Ensuring that all count sheets are pre-numbered and collected after the inventory is complete.
  - ♦ Checking all counted items to ensure that they are clearly marked or tagged to avoid omitting any.
- Train its staff in proper inventory procedures and require all personnel who participate in the inventory process to follow the new procedures.
- In its contracts with auction companies, require auction lists of sold and unsold items to include the inventory tag number and the exact same description as is included on the CLO's list of inventory available for auction, and reconcile the lists to ensure that all inventoried items are accounted for.

Department Action: Corrective action taken.

The department states that the CLO has completed a review of its fixed asset inventory policies and procedures manual and made the necessary modifications to ensure that all of the above recommendations were properly included. The revised manual was finalized on September 10, 2001, and will be used for all future inventories.

Finding #2: The CLO does not ensure that investment decisions are optimized.

We found that the CLO is not as effective as it could be in managing insurers' invested assets and budgeting for its operations, because it does not regularly update the individual closing plans for the estates it manages. Since 1998, the CLO has failed to update its estate closing plans, and it has never included an estimation of each estate's future cash flows as part of those plans. This information would be very helpful to its investment managers in maximizing the assets of the estates they manage. In 1998, the

CLO did prepare an aggregate cash flow projection that aided its investment managers. Since then, however, the CLO has neither updated estate closing plans nor projected its cash flow needs, so this information has been unavailable for making investment decisions or to more accurately budget for its operations.

In addition, since 1995, the CLO has not reviewed its investment guidelines or performance benchmark to ensure that its investment strategy is appropriate, even though the size of its investment pool has more than tripled since then. In addition, in calendar year 2000, the CLO paid $930,000 to its investment managers, but since 1998, it has not evaluated the fees it pays to ensure that they are reasonable when compared to what other investment firms would charge to manage a pool of similar value. Consequently, the CLO may be needlessly spending estate funds on fees for its investment managers.

To maximize the return on the assets it manages, we recommended that the department ensure that the CLO takes the following actions:

- Update estate closing plans and include estimates of the future cash needs for each estate. The CLO should use this information to ensure that it reaches its goal of maximizing estate assets and to accurately plan and budget for its operations.

- Periodically reevaluate its investment strategy and benchmark to reflect changing conditions and requirements.

- Periodically review its contract for investment management services to determine whether the fees it pays are reasonable compared to what other investment managers would charge to manage an investment pool of similar value.

Department Action: Corrective action taken.

The department states that the CLO has completed updating estate plans for the 55 estates under its control as of July 2001, and developed a schedule to keep them updated.

In March 2001 the CLO requested the current investment management firms to provide their recommendations for modifying the investment strategy, and in July 2001 decided not to modify the current strategy or benchmark. In addition, in August 2001 the CLO issued a request for proposal for investment management services.

Finding #3: The CLO did not always follow its procedures for awarding and managing contracts for professional services.

The CLO does not adequately manage its contracts to ensure that contract managers follow its competitive bidding policy, which specifies only three circumstances when obtaining competitive bids is not required. Two of the 10 contracts we reviewed should have been competitively bid but were not, and the reasons the CLO gave for using sole-source contracts did not appear to qualify under any of the exceptions listed in its policy. When the CLO fails to properly control and monitor its contracts, estate assets may be spent improperly or unnecessarily.

We recommended that the department see to it that the CLO:

- Amend its contracting policies and procedures to define how managers should seek competitive bids, including the type of documentation required for bids obtained by telephone, and ensure that its contract managers understand and adhere to the CLO's contracting policies and procedures.

- Assign each contract a unique number and require its contract managers and accounting staff to track payments made using a spreadsheet or other means as a control against misapplied payments or overpayment.

- Review contracts periodically to determine if and when they should be renewed, and require all contractors to adhere to all contract terms and conditions.

- Ask one vendor who provided security services to pay back $43,340 in overpayments due to the CLO paying a higher rate than its contract specified.

Department Action: Partial corrective action taken.

The department states that on September 12, 2001, the CLO completed a contracts manual that is based on the policies and procedures used by the department. The CLO plans to expand the manual to include detailed processes to be followed for the various methods used to procure services. In addition, the CLO established a contract coordinator position that is responsible for ensuring that the contracting policies and procedures are followed. Finally, the CLO sent a demand letter to the contractor that received the overpayment on July 27, 2001. The contractor agreed to pay back the overpaid amount by December 14, 2001.

Finding #4: The CLO does not ensure that it hires and promotes qualified staff.

The CLO does not ensure that it hires and promotes the most qualified applicants. For example, the CLO hired two applicants and promoted one employee who did not appear to meet the CLO's minimum qualifications. Consequently, the CLO cannot be certain that it is employing the most qualified personnel, and it may be compensating some employees for qualifications they do not possess.

We recommended that the department see to it that the CLO hire qualified applicants and promote qualified employees to positions requiring technical knowledge and experience. In addition, the CLO should also verify applicants' references, including work and education records, before making hiring decisions and should document its justification when hiring applicants and promoting employees who do not meet minimum qualifications.

Department Action: Corrective action taken.

The department states that the CLO has established a formal process to ensure that individuals who are hired or promoted meet the minimum qualification requirements of the position classification, and that references, including work and education records are always checked. The new process is documented in the CLO's procedure manual.

Finding #5: The CLO is not sure that its salary levels are still competitive.

Although the CLO has obtained market trend reports for salary scales, it has not considered and evaluated this data. As a result, the CLO has not adjusted its structure for salary ranges since 1995. When the CLO does not periodically evaluate its salary structure, it cannot be sure that its salaries are reasonable and remain competitive enough to attract and retain qualified applicants.

To ensure that its salaries remain competitive, we recommended that the department have the CLO evaluate its salary structure, using both private and public sector comparisons, to ensure that it attracts and retains qualified employees.

Department Action: Corrective action taken.

The department reported that the CLO has completed its review of its salary structure. This evaluation includes both private and public salary comparisons.

Finding #6: The CLO has never established a comprehensive conflict-of-interest policy for its employees and contractors.

The CLO has never had comprehensive conflict-of-interest policies and guidelines for its employees and vendor contractors to follow. Because it lacks comprehensive conflict-of-interest policies and guidelines, the CLO cannot ensure that its employees and contractors adequately safeguard sensitive information and act in the best interest of the estates it manages.

We recommended that the department instruct the CLO to:

- Finalize, approve, and implement a conflict-of-interest policy similar to the policy used by state agencies.

- Require all designated employees and multiyear contractors to complete an annual conflict-of-interest statement.

Department Action: Pending.

The CLO is drafting its conflict-of-interest code and statement of incompatible activities. Senate Bill 80 authored by Senator Speier established an implementation deadline of February 1, 2002. The bill was chaptered in October 2001.

Finding #7: The CLO's basis for allocating fixed costs unfairly burdens some insurers.

We found inequities in the CLO's basis for allocating its fixed costs to estates. Moreover, the CLO does not regularly review the status of estates to identify those that meet its criteria for sharing the fixed costs. For example, we found that for one estate the CLO did not allocate more than $4,000 for one month's fixed costs despite the fact that staff spent 94 direct hours working on this estate's activities.

We recommended that the department have the CLO:

- Review other options for allocating fixed costs to insurers that are more equitable than its current method, and implement a method that allocates fixed costs to all insurers' estates with assets that benefit from these costs.

- Develop a system of review to ensure that insurers who should be paying a portion of the fixed costs are included in its allocation process and that insurers who should not be included are not paying these costs.

Department Action: Corrective action taken.

The department states that the CLO has reviewed the various types of costs that need to be allocated to insurers' estates and has worked with the department to finalize a methodology for allocating these costs. The CLO completed the analysis in October and will use the new methodology to allocate September expenditures. The department also states that as new costs are incurred or estates come under the CLO's control, it will evaluate the appropriateness of the cost allocation system for those costs and estates.

Finding #8: The CLO spent millions in estate assets to implement a claims processing system that does not effectively support its operations.

Although the CLO has spent more than $5.7 million to implement the claims processing system it purchased in 1995, the claims system continues to be costly and inefficient, and it does not effectively support the CLO's operations. For example, although the claims system was purchased in part to improve the CLO's reinsurance claims process, reinsurance recovery claims continue to be handled manually—a process that is inefficient and prone to error. Unless the CLO properly accounts for all of its reinsurance contracts and establishes receivables for all amounts due, it cannot ensure that it bills for all the reinsurance it is entitled to and promptly collects payments owed to avoid losing interest earnings because of delayed reinsurance payments, thus providing fewer funds to pay the insurance companies' creditors.

We recommended that the department instruct the CLO to:

- Work diligently toward defining its overall claims processing system needs. If it chooses to purchase a new claims processing system, the CLO should explore the option of alternative procurement, whereby the software company would have a direct financial stake in the successful implementation of the claims system.

- Ensure that reinsurance claims are both properly accounted for and promptly billed.

Department Action: Pending.

The CLO issued a request for proposal on August 10, 2001, to acquire the necessary assistance to find a solution to the CLO's overall claims processing and reinsurance collection needs. The CLO states that the proposals of the prospective firms have been received and reviewed, and a firm was selected in October 2001.

The CLO is currently reviewing its system and processes for promptly identifying and collecting on reinsurance claims and plans to make appropriate modifications to procedures based on the results of the review. In addition, the CLO is in the process of developing a request for proposal for assistance in maximizing the recovery of reinsurance. The fees paid to the selected vendor will be based solely on the recoveries made.

Finding #9: The department's flawed oversight of the CLO weakens its ability to ensure that the CLO properly safeguards and manages estate assets.

Although the department considers the CLO to be exempt from several components of the State's control system, it has failed to take the steps necessary to otherwise oversee the CLO's activities. For example, although the CLO's internal auditor acts as an oversight arm for the department, it does not require the internal auditor to adhere to the department's policy that requires a two-year internal audit cycle. In fact, the current audit plan does not have the internal auditor completing his first audit cycle until 2002—nearly five years after its start. Consequently, the internal auditor has not yet reviewed the CLO's operations in some important areas, such as its processes for inventorying the assets of the insurers it manages, preparing budgets, and the operation of its information systems. Had the department enforced its policy, some of the weaknesses we detected might have been identified and corrected sooner.

We recommended that the department:

- Strengthen its oversight process by ensuring that the CLO's accounting and administrative controls are periodically monitored and the highest-risk areas are promptly reviewed by requiring the internal auditor to complete a full audit cycle at least once every two years.

- Ensure that when the CLO's internal auditor reports on control weaknesses and recommends improvements, the CLO implements such recommendations or documents why it does not.

- Follow up on the CLO's efforts to implement recommendations for improvement made by external auditors and ensure the status of those efforts is regularly reported.

Department Action: Corrective action taken.

The Insurance Commissioner (commissioner) established an audit/oversight committee that will have full access and oversight of the operations of the CLO. This committee's duties will include such things as the CLO budget and all audit activities and other functions requested by the commissioner. The committee held its first oversight meeting on September 13, 2001, and will meet at least quarterly.

To ensure that the CLO's accounting and administrative controls are periodically monitored, the CLO will have the Department of Finance complete an internal control review once every two years and high-risk areas will be reviewed by CLO internal audit staff. Additionally, the audit/oversight committee will review the CLO audit plan.

To ensure the accurate and prompt follow up and implementation of both internal and external audit recommendations, the department states that it has made several changes, including moving the CLO internal audit function from the CLO to the department and formalizing follow-up procedures for implementing recommendations.

DEPARTMENT OF JUSTICE

It Continues to Use the Improvements It Made to the California Witness Protection Program

REPORT NUMBERS 98024, FEBRUARY 1999; 99024, NOVEMBER 1999; 2000-012, NOVEMBER 2000; 2001-013, DECEMBER 2001

Audit Highlights . . .

The Department of Justice (department) has improved controls over the California Witness Protection Program (CWPP). Our most recent audit found that the department has made improvements that meet our previous recommendations. These improvements include:

- ☑ *Establishing a formal review process for approving applications and reimbursements.*
- ☑ *Ensuring that staffing is sufficient to perform program activities.*
- ☑ *Performing field audits of district attorneys' offices participating in the CWPP.*
- ☑ *Updating the CWPP policies and procedures manual.*

As required by the 1998–99 Budget Act, we conducted an audit of the Department of Justice's (department) California Witness Protection Program (CWPP). In response to requirements of subsequent budget acts, in November 1999, November 2000, and December 2001, we performed follow-up audits to examine the department's implementation of our recommendations. During these audits we noted the following conditions:

Finding #1: The CWPP does not have consistent management oversight.

Because only one analyst operates the CWPP, program responsibilities are concentrated and the department may not detect errors or omissions. In addition, the department does not always ensure that it has all the proper documents before it pays program costs. As a result, the department may reimburse costs of services for ineligible witnesses.

We recommended that the department establish a formal management-review process for the approval of applications and reimbursement requests. The department should deny payments on claims when crucial documents, such as applications and witness agreements, are missing or incomplete.

Department Action: Corrective action taken.

The department has implemented a checklist system to ensure that all necessary documents are received before reimbursements are processed. Also, the department has implemented formal management oversight procedures. Now a division manager has final approval of all program applications and reviews each reimbursement request prior to payment.

Finding #2: The program may lack the necessary staff to handle anticipated growth.

The program is assigned one analyst who performs all of its day-to-day activities. However, this analyst is already using limited overtime to complete the work. Any delays in processing claims or approving cases could delay payments to counties, or possibly place witnesses at risk.

We recommended that the department conduct a workload analysis to ascertain the CWPP's staffing needs. The department should also find staff who can back up the primary program analyst when necessary.

Department Action: Corrective action taken.

The department has hired a temporary analyst to serve as an immediate backup to the CWPP's primary analyst. We believe the staffing level of the CWPP is adequate for the current caseload, but the department should continue to monitor its staffing needs as the program grows.

Finding #3: The department does not independently ensure the propriety of expenditures at the district attorneys' offices.

As a result, the department has no way of knowing with any certainty that underlying support for reimbursement claims actually exists, or that the claims comply with CWPP requirements. The department therefore risks paying improper or misstated claims.

We recommended that the department perform periodic field audits to ensure that the district attorneys' offices are:

- Only claiming allowable costs.
- Using other funding sources before applying to the CWPP.
- Administering the program consistently.

Department Action: Corrective action taken.

The department has begun to perform periodic field audits to ensure that district attorneys' offices are claiming only allowable costs and are using the CWPP consistently. As of our December 2001 report, it had completed eight audits of district attorneys' offices and was in the process of completing another.

Finding #4: A formal reconciliation process between program and accounting records does not exist.

After the program analyst forwards a claim to the accounting department for payment, she has no way of knowing whether the claim was paid and if so, whether the payment was correct, prompt, or recorded accurately.

To account for all CWPP transactions, we recommended that the department develop and perform periodic reconciliations between accounting and program records.

Department Action: Corrective action taken.

The department has implemented procedures to periodically reconcile program and accounting records for all CWPP transactions.

Finding #5: The department has not adequately clarified certain policies in its manual to ensure consistent, appropriate use of CWPP funds.

To promote consistent administration of the program and help ensure that the department and the district attorneys' offices properly account for and spend CWPP funds, we recommended that the department specify in its policies and procedures manual how the district attorneys' offices should account for housing and utility deposits and meal receipts. We also recommended that the department periodically review established program rates and make adjustments as needed. In addition, the department should hold an informational workshop for the district attorneys' offices regarding the administration of the CWPP.

Department Action: Corrective action taken.

The department updated its policies and procedures manual to modify requirements related to meal receipts and unused portions of housing deposits. Further, it has plans to make additional revisions to its policies and procedures manual and in the interim has issued a policy memorandum.

The department reports that it has also taken advantage of opportunities to inform representatives from the district attorneys' offices about the use of the CWPP. The program analyst indicated that, as of October 2001, she has presented 26 briefings and workshops explaining various aspects of the CWPP and has scheduled three more training sessions for the future.

Finding #6: The department has not documented its basis for denying certain cases.

The program analyst has not maintained any records documenting the applications denied over the phone or the rationale for the decisions. Because the department has not documented these requests, it cannot ensure that its policies are consistently applied.

We recommended that the department maintain written records documenting the reasons that it denied certain applications.

Department Action: Corrective action taken.

The department has developed and implemented a case-denial form to document all cases it denies.

DEPARTMENT OF MOTOR VEHICLES

Although Unable to Measure the Extent of Identity Fraud and the Effect of Recent Reforms, It Should Improve Its Technology, Procedures, and Staffing Further

REPORT NUMBER 2001-103, SEPTEMBER 2001

Audit Highlights . . .

Our review of the Department of Motor Vehicles (Motor Vehicles) to determine whether it has adequate procedures and resources to detect or prevent the issuance of fraudulent documents revealed that:

- ☑ *Motor Vehicles lacks the technology to use the computer-mapped finger images it collects to verify the identity of all applicants for driver licenses and ID cards.*
- ☑ *Motor Vehicles cannot accurately quantify the effect of new procedures aimed at detecting or reducing fraud.*
- ☑ *Motor Vehicles can implement further procedures such as requiring two employees to verify photos it retrieves for existing customers obtaining a temporary license, driver license, or ID card.*

continued on next page

By issuing driver licenses and identification cards (ID cards)—California's basic identification documents—the Department of Motor Vehicles (Motor Vehicles) enables residents to establish who they are for the purposes of driving, getting jobs, and making basic financial transactions such as purchasing goods and opening lines of credit. In fiscal year 2000–01, Motor Vehicles issued about 8 million driver licenses and ID cards, with an unknown number of them going to people who managed to outwit the issuing system and obtain fraudulent driver licenses or ID cards by taking over someone else's personal information and "becoming" that person.

At the request of the Joint Legislative Audit Committee, we reviewed the procedures Motor Vehicles uses to issue driver licenses and its resources to determine whether they are adequate to detect or prevent the issuance of fraudulent documents. We also reviewed Motor Vehicles' process for issuing ID cards, because the procedures are similar to those used to issue driver licenses. Based on our review, we found the following:

Finding #1: Motor Vehicles cannot use existing computer-mapped finger images to verify customer identity.

Although Motor Vehicles uses finger images to investigate potentially fraudulent applications, it cannot use them to verify the identity of all customers applying for driver licenses or ID cards because of inadequate technology, questionable image quality, and privacy concerns from opponents of finger imaging.

Because it lacks the necessary technology, Motor Vehicles cannot ensure that a customer applying for a renewal or duplicate driver license or ID card is the true holder by conducting a one-to-one search, which would compare a finger image in its database against the image the customer is providing in person. Technology limitations

- ☑ *Motor Vehicles can better help employees prevent fraud by standardizing its fraudulent document detection training course.*
- ☑ *Motor Vehicles' Investigations and Audits Division, responsible for investigating fraud, lacks adequate policies, procedures, and resources.*

also prevent Motor Vehicles from making sure that a new customer does not already hold a driver license or ID card under another name by using a one-to-many search, which would compare a new or existing finger image with all other images in the database. Additionally, although the finger images in Motor Vehicles' existing database date back to early 1990, Motor Vehicles was not able to collect finger images that meet Federal Bureau of Investigation standards until 1999. Furthermore, after three unsuccessful attempts at capturing an acceptable image, field representatives can force the software to accept the image and record the last print taken, which may or may not be readable. Therefore, the finger images that Motor Vehicles has taken may not support computerized searches even if it does receive the funding to upgrade its technology. Finally, some opponents of the use of finger imaging have raised both legal and policy concerns about the potential for this technology to interfere with individual privacy rights. However, with appropriate limitations on their use, finger images can be a legal and effective way to reduce identity fraud that can harm the public.

We recommended that the Legislature should reconsider funding to support an upgrade of Motor Vehicles' finger-imaging technology if recent reforms to the process for issuing driver licenses and ID cards prove insufficient. If it provides the funds, the Legislature should consider protecting against unauthorized dissemination of finger images by allowing only those entities it believes have a legitimate interest in protecting the public, such as state and local law enforcement agencies, to access Motor Vehicles' finger-imaging data. The Legislature should also consider imposing criminal sanctions for unauthorized use of the data. Further, if the Legislature approves the use of finger imaging, it should consider directing Motor Vehicles to establish controls that protect the privacy of California citizens.

Finally, Motor Vehicles should train its field representatives to capture good-quality finger images and prohibit them from bypassing system requirements for obtaining readable customer images without prior approval from their managers.

Legislative Action: Unknown.

We are unaware of any legislative action implementing these recommendations.

Department Action: Pending.

Motor Vehicles states that it has begun work on a business case that will include a legislative proposal to authorize it to implement an Automated Fingerprint Identification System. While funding will be a prerequisite to implementation, Motor Vehicles states that it will not request funding at this time because it cannot accurately estimate the costs. Motor Vehicles' proposal will include a synopsis of current statutes, policies, and court rulings that it follows to prevent the unauthorized dissemination of confidential data, including finger images.

Motor Vehicles has also appointed a chief privacy officer and is drafting a privacy policy as required by California Government Code, Section 11019.9. Adherence to this privacy policy will also become a requirement of any future fingerprint identification system.

According to Motor Vehicles, on October 3, 2001, two field offices began conducting a survey to analyze the thumbprint capture process. The purpose of the survey is to identify any gaps in current training, procedures, or equipment use, and determine whether supervisory approval for overrides is necessary. Motor Vehicles anticipates reporting survey results in March 2002.

Finding #2: Its recent reforms should reduce fraud, but Motor Vehicles cannot measure their impact.

Between October 14, 2000, and January 2, 2001, Motor Vehicles implemented reforms to prevent the issuance of fraudulent driver licenses and ID cards. Motor Vehicles began verifying Social Security numbers with the federal Social Security Administration, retrieving renewal customers' most recent photographs from its database, and requiring two employees to verify birth-date and legal-presence documents that customers present to obtain original licenses. However, Motor Vehicles cannot accurately quantify the effect of its new procedures for three reasons. First, Motor Vehicles has inadequate methods of tracking potential fraud. Second, changes in the way Motor Vehicles categorizes and investigates fraud make it difficult to compare the number of potential fraud cases identified before and after the new procedures were in place. Third, the effect reforms have on preventing attempts to obtain fraudulent driver licenses or ID cards is impossible to measure.

Motor Vehicles should establish mechanisms to measure the effectiveness of its recent and future reforms because until it does there is no way of knowing how successful its recent reforms have been in reducing identity fraud.

Department Action: Pending.

Motor Vehicles is in the process of identifying performance measures that will quantify the effects of its fraud reforms.

Finding #3: Despite promising reforms, more improvements are needed to reduce fraud.

Although Motor Vehicles has taken significant action to reduce the possibility of issuing fraudulent driver licenses and ID cards, some reforms could be expanded. For example, photo retrieval to identify a prior customer would be a stronger reform if a second employee confirmed the original field representative's verification that the customer matched the retrieved photograph. Also, our review of the processes for issuing driver licenses and ID cards revealed additional opportunities for Motor Vehicles to improve its controls to reduce fraud. For instance, Motor Vehicles has yet to evaluate or implement most of the recommendations of its Anti-Fraud Task Force (task force) on ways to reduce driver license and ID card fraud. Finally, since the new fraud prevention procedures have increased the average waiting times of customers with appointments by 1.5 minutes and customers without appointments by 9.3 minutes, Motor Vehicles needs to continue its efforts to improve customer service and mitigate this effect.

To further improve its existing controls and reduce waiting times for customers at field offices, Motor Vehicles should take the following steps:

- Instruct its Driver License Fraud Analysis Unit (Fraud Analysis) to conduct a study to determine the benefits of verifying identification by comparing new photos of existing customers obtaining temporary licenses, driver licenses, or ID cards with photos already in the Motor Vehicles' database.

- Establish deadlines for staff to address all of the task force recommendations and conduct a timely evaluation of the merits of each recommendation.

- Continue its efforts to decrease field office waiting times by installing additional electronic traffic management systems and posting real-time data to its Web site. Also, it should complete a staffing analysis to assess the impact that the recent reforms have had on its ability to carry out its procedures.

Department Action: Pending.

Motor Vehicles believes that the number of records related to driver licenses and ID cards issued to existing customers with new photos is greater than 1.2 million. It states that because of Fraud Analysis' increasing workload, and the current hiring freeze, it will need to evaluate how the recommended study can be undertaken with the least amount of disruption to Motor Vehicles' services to the public.

Motor Vehicles reports that 20 task force recommendations have been approved of which 12 have been implemented and 8 are in the process of being implemented. Motor Vehicles expects responsible divisions to complete the analysis of 36 additional recommendations by March 31, 2002.

Motor Vehicles is planning to install electronic traffic management systems in 33 additional offices from December 2001 through June 2002. Motor Vehicles also plans to begin posting wait time data on its Web site during fiscal year 2002–03. Finally, Motor Vehicles states that it is in the process of identifying the appropriate methodology to accurately complete a staffing analysis to assess the impact recent reforms have had on its ability to carry out the new fraud procedures.

Finding #4: Motor Vehicles fraud detection training needs improvement.

Motor Vehicles is not maximizing the benefits of its training course in detecting fraudulent documents. The Field Operations Division (Field Operations) and field office managers' goals conflict regarding which employees should receive the training. Also, database flaws prevent Field Operations from knowing if it even meets its goals. Further, in interviewing trainees and reviewing departmental evaluations, we found significant concerns with the trainers, the curriculum, and available resources. Problems include a lack of hands-on experience with original documents, uniformity among trainers' presentations, and time to cover the material. Consequently,

the training is less useful to employees responsible for fraud detection and prevention and a less effective tool for Motor Vehicles in its efforts to reduce the issuance of fraudulent driver licenses and ID cards.

To improve its fraudulent document detection training, Motor Vehicles should take the following steps:

- Instruct Field Operations management to meet with field office managers to reiterate training expectations and monitor them for compliance with Field Operations' training goals.

- Correct training database errors and modify the Departmental Training Branch's database to allow users to view and sort employees' attendance at the training course for fraudulent document detection by reporting unit location.

- Continue to communicate with trainers and supervisors regarding Motor Vehicles' commitment to standardization and uniformity. Determine if additional funding is necessary to improve its training program.

Department Action: Partial corrective action taken.

Field Operations management has reiterated to field office managers its training expectations and short- and long-term training goals as they relate to fraudulent document detection training. Additionally, it generates a weekly report to reflect all field office personnel who have received this training and shares this information with region and office managers monthly.

Motor Vehicles states that discrepancies in the tracking of training for fraudulent document detection have been identified and resolved. The Departmental Training Branch also requested a modification of its tracking system to allow viewing and sorting of the information by reporting unit location.

Finally, Motor Vehicles reports that its Investigations' management has met with all training staff and instructors to emphasize the necessity for standardization and uniformity of fraudulent document detection training. A smaller working group has also been established to update the course curriculum. This group met the first week in November 2001. However, it plans to wait until appointments are made to the two vacant management positions within Investigations to finalize the plans for the continuing operation of the training program.

Finding #5: Missing procedures and flawed data prevent Motor Vehicles from properly managing its fraud complaints.

Despite its safeguards against driver license and ID card fraud, Motor Vehicles finds that both customers and employees sometimes violate procedures and break the law. Motor Vehicles' Investigations and Audits Division (Investigations) is responsible for looking into cases of possible fraud. However, a lack of procedures and resources hinder Investigations' inquiries into driver license and ID card fraud. Without improvements, Investigations will remain limited in how well it can carry out its mission of stopping fraud, assisting victims, and helping to prosecute wrongdoers. For example, the Field Investigations Branch (Field Investigations) lacks procedures dictating how its staff should manage and resolve complaints. Consequently, Motor Vehicles cannot accurately determine how long it takes to conduct an investigation from start to finish and what its true staffing needs are. A weakness in Field Investigations' case management database also prevents its investigators from sharing information such as current fraud trends. Finally, Fraud Analysis lacks sufficient staffing to handle an increased workload caused by Motor Vehicles' new fraud prevention procedures and consumer fraud hotline.

To increase its effectiveness in preventing fraud, assisting victims, and helping to prosecute wrongdoers, Motor Vehicles should take these actions:

- Establish procedures to more effectively manage its complaints and track accurate data. These procedures should cover, at a minimum, logging a complaint on receipt, promptly sending an acknowledgment letter to the complainant, prioritizing and assigning complaints, and deadlines for completing the investigation and reporting the results.

- Evaluate the feasibility of upgrading the case management database so that field offices can share data.

- Evaluate the staffing needs of Investigations' branches and units.

Department Action: Pending.

Because Investigations still has two vacant management positions, no reportable progress has been made toward establishing procedures for more effectively managing its complaints and tracking accurate data or studying the feasibility of upgrading its case management database.

Finally, Motor Vehicles' study to evaluate the staffing needs of Investigations' branches and units will not be complete until end of March 2002.

Finding #6: Clearer policies and definitions are needed to ensure that Motor Vehicles' Special Investigations Branch receives all employee fraud cases.

Motor Vehicles has not established a clear policy that precisely identifies the role of the Special Investigations Branch (Special Investigations) in investigating employee misconduct. Moreover, clear definitions of employee misconduct and fraudulent or dishonest behavior do not exist, creating inconsistencies in staff reports of possible fraudulent activity. Until it clearly establishes definitions and policies, and identifies Special Investigations' role in investigating employee misconduct, Motor Vehicles cannot ensure that it investigates all questionable employee activities or that employees participating in these activities receive consistent discipline.

To increase its effectiveness in preventing employee fraud, Motor Vehicles should establish a clear policy that identifies Special Investigations' role in investigating employee misconduct; defines such misconduct; and clarifies how employees, managers, and regional administrators are to report employee misconduct.

Department Action: Pending.

Special Investigations reviewed all of its policies and procedures regarding employee misconduct to identify conflicting statements, and is in the process of drafting a new comprehensive policy.

BLACKOUT PREPAREDNESS

The Office of Emergency Services and the California National Guard Each Have Weaknesses in Their Blackout Preparations

REPORT NUMBER 2001-111.1, SEPTEMBER 2001

The Joint Legislative Audit Committee asked us to determine whether the California National Guard (CNG) has a plan to deal with blackouts resulting from the State's energy shortage. Our review also includes an evaluation of the Office of Emergency Services' (OES) plan since it is primarily responsible for assuring the State's readiness to respond to and recover from man-made emergencies such as electrical blackouts. Specifically, we found:

Finding #1: The OES has an alternative power source during a blackout but other concerns about its preparedness exist.

In the event of a blackout, the OES has a generator at its headquarters as an alternative power source. The OES headquarters houses its State Operations Center, which is one of the key locations it uses to receive and process local government's requests for assistance. According to the OES, it runs and inspects the generator on a regular basis, which is a reasonable precautionary step to ensure that this critical facility will have power. However, the OES may have other weaknesses that can affect its blackout preparedness.

In March 2001 the OES distributed to its staff an Energy Shortage Response Matrix (response matrix), which provides background and insight into potential public safety impacts, state actions to date, and its policy relating to energy responses. For example, the OES found that an evaluation of its plans for transferring responsibilities for critical functions to unaffected units and relocating staff to an alternative work site was necessary to refine its Business Continuity Plan (continuity plan). It also recognized the need to evaluate its continuity plan and emergency procedures to ensure back-up systems are operating and whether it could handle a natural disaster during an energy crisis. The OES asserts that it has taken steps to address some of the activities found in the matrix, but we are uncertain if or how it has resolved a few key concerns it raised in its response matrix.

To strengthen its blackout preparedness, the OES should, at a minimum, review and document its efforts to ensure that its relocation and transfer plan, business continuity plan, and emergency procedures address sufficiently the State's energy situation.

➲ ***Department Action: None.***

The OES 60-day response to our recommendations was simply a reiteration of its original audit response letter. The OES states that weaknesses in blackout-specific preparedness activities were already addressed by pre-existing, all-hazard emergency management practices. We disagree. The OES prepared a response matrix in March 2001 and for certain potential public safety impacts, the OES identified additional steps it should take to minimize disruptions to its operations. For example, it recognized the need to evaluate whether it could handle a natural disaster during an energy crisis. Because the OES identified these concerns itself, it seems clear that they were not already addressed by pre-existing practices as the OES is now claiming.

Further, we disagree with OES' belief that its continuity plan and Relocation and Transfer Plan can address a potential blackout situation. In June 2001 the OES identified concerns with its continuity plan and Relocation and Transfer Plan. Moreover, since the OES did not provide us with any evidence such as changes it made or changes that may be pending during the audit or as part of its most recent response, we question whether it has taken the necessary steps to resolve its concerns about its own preparedness.

Finding #2: The OES has taken steps to inform the emergency response community and others about blackouts but some efforts could be stronger.

In addition to preparing itself for blackouts, the OES has worked with the emergency response community to share information about the energy crisis and assist them in planning for blackouts. The OES has also implemented a notification process that provides for a series of alerts prior to a potential blackout. However, the OES lacks a way to evaluate its effectiveness and therefore, may overlook necessary changes or improvements. Finally, the OES developed a guide for local governments in planning for power outages. Although this document addresses many critical planning

issues, the OES may not be able to assist local governments because it has not designated staff to respond to inquiries nor has it trained its staff on how to use the planning document.

We recommended that the OES establish a method to periodically evaluate its notification process, which includes documenting the results of its evaluations and following up with participants to ensure that all necessary changes are made. In addition, the OES should assign specific staff to be responsible for responding to local governments' inquiries about its power outage planning guide. It should also train these staff on how to use the guide and advise local governments on their planning efforts.

➲ ***Department Action: None.***

The OES 60-day response to our recommendations was simply a reiteration of its original audit response letter. The OES states that there is no need for it to specifically evaluate its notification process because the OES uses these same tools for all other types of disasters and emergencies daily. We disagree. In a meeting held on August 14, 2001, the deputy director of Emergency Operations, Planning and Training Division agreed that a formal, periodic assessment of how the notification process is working would be beneficial to identify process improvements. The deputy director also told us that the OES' blackout notification process improved upon its prior notification procedures. For example, it allowed for expanded use of its Emergency Digital Information Service and the incorporation of its Response Information Management System. Therefore, we would expect the OES to ensure that these new enhancements are effective.

The OES stated further that even though there are some issues unique to blackouts, there is no need to designate or train staff to respond to local government's inquiries because these capabilities exist within its structure already. We disagree. Because the OES did not designate and train staff to accept these inquires, there is a potential that when the local governments contact the OES for assistance, they may get passed on to multiple staff and not receive the help they need at all. Moreover, because as the OES states there are issues that are unique to blackouts, despite their technical expertise in overall emergency management operations, staff may not be able to assist the local government in using OES' Electric Power Disruption Toolkit for Local Government.

Finding #3: Although its communication systems are redundant, the CNG's lack of maintenance weakens these systems.

The CNG's outage plan specifies that the armories are to rely on commercial telephone systems as the primary means of communication. If commercial services are unavailable, the plan directs staff to use two alternative communication methods: high frequency radios (HF radios) and cellular phones. Although the CNG's outage plan appears reasonable in that it provides for redundant methods of communication, because the CNG does not ensure that its HF radios and cell phones are intact and operational, it cannot be certain that these alternatives will be available when necessary.

To strengthen its readiness for blackouts, the CNG should develop a plan that sets forth inspection dates for each location with a HF radio, the person responsible for the inspection, and a date certain for the completion of all repairs; and continue with these maintenance checks on an ongoing basis. In addition, the CNG should establish a process to periodically check that each cell phone is operating and the batteries are fully charged.

Department Action: Partial corrective action taken.

The CNG provided us with a maintenance schedule for its 19 HF radios including a party responsible for inspections and an inspection date. The CNG plans to inspect all the radios by March 2002. The CNG also provided information demonstrating that it had made six of its planned visits. However, the CNG still needs to establish completion dates for necessary radio repairs.

The CNG also reported that it is recalling the cell phones it issued to the armories in an effort to reduce its telecommunications expense.

Finding #4: The CNG does not monitor its tactical generators' operability.

The CNG's outage plan specifies that tactical generators may be used in CNG facilities when power is essential for safety, security, and mission requirements. The CNG normally uses tactical generators when staff are in the field and need a power supply for their equipment. Although these generators cannot be connected to the buildings' electrical system to supplant traditional power

sources, they can be used to operate portable light fixtures and radios thereby contributing to the normal operation of a CNG facility during a blackout. However, the CNG does not ensure its facilities periodically test its tactical generators. Therefore, the CNG has limited its assurance that it can use these generators in the event of a blackout.

We recommended that the CNG develop policies and procedures for testing and maintaining its tactical generators and include these policies and procedures in its outage plan. In addition, the CNG should continue to monitor the operational status of these generators.

Department Action: Partial corrective action taken.

The CNG reports that it has amended its Power Outage Plan, which now includes a requirement for field commanders to test their units' tactical generators monthly. The headquarters staff will also review monthly maintenance reports the units submit in order to monitor the generators' operational status.

Finding #5: The CNG does not include in its plan or adequately monitor its headquarters' back-up generators.

The Department of General Services expects state agency and department emergency plans to address how they will ensure that any back-up generator sources are tested and readily available. Although the CNG's plan addresses tactical generators, it does not address the back-up generator in its headquarters building. According to the Director of Plans, Operations and Security, once a week an automatic timer trips and the back-up generator will start up and run for several minutes to ensure the generator is working properly. Because the back-up generator is critical to the CNG's Joint Operations Center during a blackout, we would expect it to include this generator in its plans and to have policies and procedures in place for tracking the weekly generator test and as part of that test, inspecting the generator for sufficient fuel, leaks, or other malfunctions. However, according to the Military Support Civilian Authorities Communications Officer responsible for the headquarters' generator, no such policies or procedures exist; he simply listens for the generator to start up each week.

We recommended that the CNG update its outage plan to address its headquarters' back-up generator that it needs to operate its Joint Operations Center, periodically inspect it for leaks, check its fuel

levels and other critical elements, and execute a maintenance contract to ensure that more extensive inspections occur on an ongoing basis.

Department Action: Partial corrective action taken.

The CNG amended its Power Outage Plan to include weekly tests of its headquarter's back-up generator. In addition, the CNG developed a preventative maintenance inspection checklist to follow when testing the generator. Finally, the CNG provided a description of its scope of work for a commercial contractor to service its generator. The CNG has not let the contract yet as it is trying to determine how the new contract affects an existing warranty.

GOVERNOR'S OFFICE OF EMERGENCY SERVICES

Investigations of Improper Activities by State Employees, Report I2001-2

ALLEGATION I990186, SEPTEMBER 2001

We investigated and substantiated that the Governor's Office of Emergency Services (OES) improperly awarded a sole-source contract and failed to follow proper contracting procedures. Specifically, we found:

Audit Highlights . . .

An executive and a contract manager at the Governor's Office of Emergency Services (OES):

- ☑ *Falsely claimed that they had made reasonable attempts to identify alternative and competitive sources of training services and that they had verified references for their preselected vendor.*
- ☑ *Misled their deputy director about the subject matter of training to be provided. Then they exceeded their authority by changing the scope of the contract without proper approval.*

OES:

- ☑ *Made payments for expenses not allowed under state regulations and entered into other contracts lacking sufficient specificity.*

Finding #1: OES improperly awarded a sole-source contract.

Contrary to their representations, an OES executive and a contract manager did not seek an alternative source for a $37,500 contract for training services. After amending the contract to total $77,500, OES paid the contractor the full per-person amount even though the full number of people did not attend the training. OES denied other entities the right to compete for this business and may not have received the best training at the best price.

In addition, an OES assessment form indicates OES verified the contractor's references, but it did not. The form also indicates that OES received the consultant's resume and verified his experience, but there was no documentation in the file to support that statement. As a result, the individuals responsible for approving contracts may be making decisions based on false or misleading information.

Finding #2: OES employees misled their superior to obtain contract approval and then changed the terms of the contract.

The same OES executive and contract manager also misled their deputy director about the nature of training being purchased through another contract because they believed she would not approve the training they wanted to offer. After the deputy director approved the $36,985 contract, the employees changed the training from the specified course to another that was part of a longer certification program. Ultimately, the contract was amended to total $90,588. Although OES told us that its practice is to allow someone at the executive's level to change the scope of a contract

as long as it does not change the dollar amount, the executive did not have specific authority to approve contracts. Further, it appears that OES paid more for the training than necessary.

➲ ***OES Action: Partial corrective action taken.***

OES disagrees that its executive and contract manager misrepresented their efforts to identify alternative sources of training and misled their deputy director. OES contends that any mistakes that occurred probably occurred because of an imperfect understanding of state contracting rules, a lack of formal contract management training, and an incomplete contract tracking system. However, OES will review contractor A's bills to determine if billing errors occurred. If so, OES will recover any overpayments or seek additional training. OES promoted the contract manager to a career executive assignment effective September 17, 2001.

Finding #3: OES paid for improper contract expenditures and mismanaged other contracts.

OES violated state regulations when it provided meals at a three-day conference for 40 managers at a cost of $3,827. In addition, OES made a questionable decision when it agreed to pay a contractor more than $1,300 for an estimated 20 hours of work.

Some OES contracts lack relevant details, which could lead to misunderstandings or disputes between the parties over contract terms. Also, some contract files did not contain sufficient information to allow individuals reviewing and approving the contracts to make an informed decision about the need for or quality of the services being purchased.

➲ ***OES Action: Partial corrective action taken.***

OES disagrees that it paid more for some training than was necessary, but agrees it should not have paid for meals for employees within 25 miles of their headquarters. OES stated that the payment occurred because of the contracting method used, and the approving official did not realize that meals were included. OES no longer uses this method of contracting.

OES reported that it has established a process that involves both its deputy director and director in approving all service contracts.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Its Policies for Foreign Investing Are Consistent With Its Mission and With Legal Guidelines

REPORT NUMBER 99138, DECEMBER 2000

Audit Highlights . . .

Our review of the California Public Employees' Retirement System's (CalPERS) foreign investment policies found that:

- ☑ *CalPERS uses a reasonable process to contract for external managers who research and administer its international investment portfolio.*
- ☑ *CalPERS investment policy is primarily based on financial factors, which is consistent with state and federal law.*
- ☑ *CalPERS uses a screening process to identify foreign financial markets in which its external managers can invest.*
- ☑ *The external managers invested in the five questioned companies because they believed the investment would be profitable.*
- ☑ *The federal government has not prohibited or restricted investment in any of the questioned companies.*

The California Public Employees' Retirement System (CalPERS) manages and administers the retirement benefits of more than one million public members. The largest public pension fund in the United States, CalPERS had net assets at June 30, 2000, of more than $172 billion. Its investment portfolio is divided into asset classes that include international and domestic stocks and international and domestic fixed income investments (primarily bonds). We reviewed CalPERS policies and procedures related to foreign investments and the rationale for investing in the five companies specified in the audit request. Specifically, we found that:

Finding #1: CalPERS uses reasonable procedures to select, contract with, and oversee its external managers.

Because it does not have the expertise and specialized skills required to invest in foreign markets, CalPERS contracts with external managers to research and administer all of its international investments. To choose those external managers, CalPERS follows a process that assures fair competition among a range of qualified applicants. To protect its assets, CalPERS then develops for each external manager a contract that specifies unique investment guidelines, contains repercussions for unsound investment practices, and requires the manager to achieve returns at least equal to a benchmark level. In addition, to make sure the external manager uses appropriate methods to invest and account for funds, CalPERS has a comprehensive oversight process.

Although in most respects CalPERS oversees its external managers adequately, CalPERS can improve the timeliness of its assessment of its general pension consultant's performance. The general pension consultant helps CalPERS determine the investment needs of the portfolio and is responsible for various monitoring procedures related to the external managers. The contract between the general

pension consultant and CalPERS does not have a set duration; instead, the contract continues in perpetuity at an annual cost of $1.9 million until one of the parties cancels it. The general pension consultant is subject, however, to a yearly review, which CalPERS has not been performing in a timely fashion. The first year of the current contract expired on June 30, 2000, but CalPERS was just beginning its review as of October 1. We recommended that CalPERS finish its review of the consultant for the year ended June 30, 2000, and establish controls so that it performs the review promptly each year.

CalPERS Action: Corrective action taken.

On December 11, 2000, and October 15, 2001, CalPERS staff presented the results of the annual reviews of the pension consultants to the investment committee. In addition, at its September 2001 meeting, the investment committee approved its staff's recommendation to hire an independent consulting firm to assist in the development and implementation of a new process to evaluate annually the performance of its pension consultants.

Finding #2: CalPERS bases its foreign investment policy primarily on financial considerations, and this practice is consistent with state and federal laws.

CalPERS' policies concerning international investments protect members' retirement benefits by directing the external managers to base their investment decisions primarily on the financial merits of the investments. To that end, CalPERS had its general pension consultant create a permissible country list of countries with financial markets that are suitable for CalPERS investment. In creating this list, the general pension consultant considered factors that make a country's market financially suitable, such as a fair, stable legal system and prudent requirements for companies to be listed on the market.

CalPERS is not the only public retirement system that bases investment decisions primarily on financial factors. Other public retirement systems in the State of California and in other states use financial criteria, rather than social or political criteria, when making investment decisions. Further, for the other asset classes within its portfolio, CalPERS also generally relies on financial criteria when making investment decisions even in instances that arise from socially motivated events. Examples of these types of decisions are the CalPERS Board of Administration's decisions to

invest in some redevelopment projects, and the board's recent decision to divest the retirement system's investment in tobacco-related stocks.

If CalPERS were to eliminate a specific country from its permissible country list based on actions of that country's government, CalPERS could be challenged as infringing on the federal government's power to set foreign policy. Specifically, in the foreign policy arena, even if a federal law does not say that it preempts state law, state law must yield to a federal law if Congress intends to enact policy measures or if state law conflicts with federal law. Moreover, the United States Supreme Court has consistently upheld the federal government's exclusive powers in setting foreign policy.

In April 1999, the CalPERS investment committee believed it found possible shortcomings in the methods the general pension consultant used to create the most current list, so CalPERS is amending these methods. These possible shortcomings may have led CalPERS to improperly classify some countries as "limited exposure" or "prohibited." Because it did not promptly create a new screening process after identifying the possible shortcomings in the procedures to develop the original list, CalPERS may be using a list that classifies countries inaccurately. Moreover, CalPERS and its general pension consultant differ in their views of the list's purpose, so the investment committee is working to establish clear objectives for the list. We recommended that CalPERS finish revising the process for developing its permissible country list and create a timetable for the review of existing criteria.

CalPERS Action: Corrective action taken.

The CalPERS investment committee has chosen to use outside research firms to develop screening criteria to be used to create the permissible country list. Two research firms, Oxford Analytica and Verite, are under contract to provide assessments of selected foreign countries. The research firms will provide three written annual reports to the investment committee. The first written report is due to CalPERS on January 1, 2002. Subsequent reports will consist of an annual evaluation of the initial assessment and are due December 1, 2002, and December 1, 2003.

Finding #3: CalPERS evaluated financial returns and followed federal law when investing in companies considered potential security risks.

Investments by CalPERS in five foreign companies have been questioned as having a possible effect on national security issues. Four of these companies are based in Hong Kong, but either the parent company is located in mainland China or the major shareholder is a company based in mainland China. The remaining company, based in Canada, is developing and constructing oil fields and pipelines in the Sudan. Our audit covering fiscal year 1999–2000 revealed that CalPERS and its external managers did not violate state or federal laws or its own policies by investing in the five companies. In each case, the managers determined that the investments would be profitable for the retirement system. Investments in these companies were purchased on either the New York Stock Exchange or the Hong Kong Stock Exchange, both designated unrestricted markets on the CalPERS permissible country list.

Based on the information we obtained, investments by CalPERS in the five questioned companies did not violate any federal laws. Investments in four of the five questioned companies were legal under federal law because the United State government does not prohibit or restrict investment in China or in companies based in China. Investment in the other company, which is based in Canada, was also legal according to federal law because although the company was doing business in the Sudan, the company was not on a federal list of companies in which the United States prohibits investing.

We recommended that if the CalPERS Board of Administration believes that the actions of a specific country's government may be contrary to international standards of human rights or may compromise national security, CalPERS should work with the State Legislature to communicate those concerns to Congress through a legislative resolution.

CalPERS Action: Corrective action taken.

The CalPERS board has sponsored Senate Joint Resolution 9, introduced by Senators Costa and Soto on March 7, 2001. This resolution would call on the President of the United States and the Congress to identify, and to place on a federal list, investments in foreign countries and businesses that pose a threat to the national security interests of the United States and to encourage appropriate federal measures to deny these entities access to capital from the United States. The resolution is held in the Senate Banking, Commerce and International Trade Committee under submission and is not subject to legislative calendar deadlines.

In addition, during the due diligence process, if issues arise regarding human rights and national security risks, the CalPERS board will act accordingly to ensure investments in foreign countries maintain high international standards for human rights and low national security risks.

DEPARTMENT OF REHABILITATION

The Business Enterprises Program for the Blind Is Financially Sound, but It Has Not Reached Its Potential

REPORT NUMBER 99020, JUNE 2001

Audit Highlights . . .

The Department of Rehabilitation could improve its fiscal administration of the Business Enterprises Program for the Blind (program) by:

- ☑ *Preparing a comprehensive business plan to better monitor and prioritize the use of its program resources.*
- ☑ *Better identifying, pursuing, and collecting vending machine commissions.*

As required by the California Welfare and Institutions Code, we conducted a fiscal audit of the Department of Rehabilitation's (department) Business Enterprises Program for the Blind (program). This, our third and final fiscal audit of the program, found that the Vending Stand Fund (vending stand fund) and the Vending Machine Account (vending machine fund) are financially sound. Each fund adequately provides for the program's needs and for the blind participants' pension plan. Nevertheless, the department could improve its fiscal management of the program by developing a comprehensive plan outlining the program's growth and by pursuing more actively the vending machine commissions that support the participants' pension plan. Specifically, we found:

Finding #1: The department could benefit from a comprehensive business plan outlining future fund use.

The program could benefit from a comprehensive business plan outlining the program's growth and the department's plans for the vending stand fund's reserves. The vending stand fund's assets exceeded its liabilities by approximately $3.8 million, of which $2.1 million—called a surplus—is available for future program purposes. However, the department has not prepared a comprehensive business plan demonstrating that its proposed uses for this surplus are appropriate and feasible. By developing such a plan, the department could better monitor and prioritize its use of this surplus.

We recommended that the department complete its strategic plan, including a component that outlines its proposed uses of the vending stand fund surplus, which will help the department determine whether the surplus is appropriate for future program needs.

Department Action: Partial corrective action taken.

The department stated that program management has prepared a strategic plan for the program, which department management is reviewing. In addition, the department is currently working on a three-year fiscal plan that will enable program management to improve overall planning for its use of the vending stand fund. The department estimates approval of the strategic plan and completion of the fiscal plan in March 2002.

Finding #2: The department could do more to collect additional vending machine commissions.

The department could increase vending machine income by identifying additional state and federal locations in which to install machines and by pursing commissions from vending machine operators or agencies that have failed to remit these commissions. Although the department asserts that it lacks the resources needed to pursue and collect commissions adequately, we found that other states have composed their statutes to allow the use of certain vending machine commissions to help administer the program. The department's failure to collect all available vending machine commissions has a direct impact on the blind vendors' pension plan, to which a majority of these funds are allocated.

We recommended that the department complete its survey of state and federal properties to identify sites for additional vending machines. Additionally, it should identify and pursue the collection of vending machine income from agencies and vending machine operators that refuse or fail to remit commissions and should verify the status of entities that claim they are exempt from having to remit vending machine commissions. Finally, to address its staffing needs, the department should evaluate whether it should redirect staff from other units, contract for professional services, or possibly seek legislation to amend state law so that the department can use some of the vending machine commissions for the hiring of staff.

Department Action: Pending.

Although it originally believed that it would be able to complete the survey report by January 1, 2002, the department has not yet completed the survey because the survey process was more complex than anticipated. However, the department has assigned additional staff to assist with the project and estimates the completion of a draft report for department management review in February 2002.

Regarding the pursuit and collection of vending machine commissions, the department's position related to commissions from the California State University system remains unchanged. The department believes that it has met its obligation to pursue commissions from the university system and has taken all reasonable steps to ensure compliance. As for its pursuit of commissions from vending machine operators that have failed to remit commissions, the department anticipates that its new vending machine operator database system will enable it to start tracking and following up on some delinquent commission payments by February 2002, with full implementation by July 2002. The department also stated that its legal staff is still reviewing the information that the California Highway Patrol provided in April 2001 regarding its exemption from having to remit commissions. The department expects to complete its review and resolve this issue in March 2002.

To address its staffing needs, the department stated that it would use the results of its strategic planning for the program to determine if it can allocate staff from other units. In the interim, staff from the technical support unit are adjusting their workload, when possible, to assist in implementing the vending machine operator database. The department is still investigating the issues involved with obtaining a private contractor to administer and collect the vending machine commissions. In addition, the department reported that it would look at staffing needs within the program and consider consulting with the federal government regarding the possibility of using commissions from machines on state property for administrative staff. The department anticipates completing its evaluations and the strategic plan for the program in March 2002.

CALIFORNIA'S VOCATIONAL REHABILITATION PROGRAM

Although Federal Requirements Have Contributed to Its Rising Costs, by More Effectively Managing the Program, the Department of Rehabilitation Can Better Serve More Californians With Disabilities

REPORT NUMBER 99111, FEBRUARY 2000

Audit Highlights . . .

Our review of the Department of Rehabilitation's (department) administration of the Vocational Rehabilitation Program (program) reveals that:

- ☑ *Program costs have more than doubled during the past nine years while the number of clients attaining employment has dropped nearly 50 percent.*
- ☑ *Federal requirements together with the failure of the department to manage the program adequately have allowed costs to escalate.*
- ☑ *The scoring instrument the department uses to identify who receives program services first favors those with certain mental and learning disabilities.*

The Vocational Rehabilitation Program (program) provides or purchases various services to assist individuals with disabilities in preparing for, entering into, and retaining gainful employment. The Joint Legislative Audit Committee (audit committee) asked us to conduct a programmatic and fiscal audit of this program. The audit committee was concerned about the program's increasing costs to serve clients, the level and consistency of services, and whether eligible individuals have equal access to services. Specifically, we found that:

Finding #1: Federal requirements along with the failure of the Department of Rehabilitation (department) to adequately manage the program have allowed costs to escalate while the number of eligible clients served who achieved their employment goals has declined.

The department's average annual cost to serve each client has increased 106 percent, from $1,225 to $2,521, over the last nine years. At the same time, the number of clients leaving the program with employment is half of what it was nine years ago. Changes in federal law have contributed to the program's increased costs. Nonetheless, other states with vocational rehabilitation programs governed by the same regulations have been more successful than California in controlling costs for their programs and in helping clients achieve their employment goals. The department's failure to manage certain aspects of the program adequately has also contributed to the program's decline. We found that the department does not track the cumulative costs of cases to keep them from becoming unreasonably high; does not identify and promptly close unsuccessful cases to avoid spending funds that could go toward services for other eligible clients; and does not monitor district performance to ensure consistent, cost-effective delivery of services.

We recommended that the department use its limited resources to benefit the greatest number of eligible clients by taking the following actions:

- Estimate the total cost of each client's plan for employment during plan development and after each major revision.
- Establish cost standards and require review and approval of plans exceeding the standard amount.
- Monitor cumulative case costs against the established standards, and take appropriate action when costs exceed the standards.

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

The department disagrees with our first three recommendations. It believes that an estimate of plan costs would be inaccurate and thus, of little value. Further, it believes establishing cost standards and monitoring cumulative case costs creates a system for controlling costs that is contrary to federal law. Although it is true that the department cannot deny services based on costs, we disagree that establishing cost standards and monitoring cumulative costs is contrary to federal law. Thus, we believe these recommendations have merit in helping the department to monitor its costs and intervene at appropriate points when costs exceed reasonable amounts.

Notwithstanding its objections to these three recommendations, the department intends to take corrective action. During fiscal year 2000–01, the department developed and initiated informed-choice training for its counselors, supervisors, and district administrators to help them write more cost-effective and goal-oriented client plans for employment. Also, to better utilize resources, the department has initiated periodic review and analysis of selected cases to compare client progress against plan goals. Counselors can then direct resources to those clients fulfilling their vocational goals. A department advisory group has submitted for management's approval a draft plan to increase supervisor scrutiny and ensure plan services are economically sound and lead to viable vocational objectives. Additionally, to assist in monitoring of outcomes and case service costs, the department plans to revise and use management information reports that trigger the review of casework practices with significant deviations, both positive and negative, from expected results.

In addition to our first three recommendations, the department should also take the following actions:

- Close cases as soon as it becomes apparent that the clients cannot attain employment.

- Identify and adopt strategies used by other states and the department's own district offices that have been effective in reducing costs and improving success rates.

- Use existing management tools to assist in monitoring the program. This may include expanding the scope of district reviews and generating management reports that highlight district performance in terms of costs and outcomes.

Department Action: Partial corrective action taken.

The department agrees with our remaining three recommendations and states it has initiated an ongoing review and analysis of selected cases at the district level to identify and develop measures that will help counselors make timely case closures. Also, the department has adopted a strategy to survey peer states on an ongoing basis to identify and adopt best practices that contribute to the department meeting its goals of increased employment outcomes, maximizing its resources, and managing its program costs. In addition, the department has conducted a survey of field staff and continues to be involved in ongoing collaborations with other state vocational rehabilitation agencies to identify and implement current best practices. Finally, despite its concern that highlighting district performance solely in terms of costs and outcomes may result in district staff limiting or reducing services based on their costs, the department has expanded the scope of periodic district reviews to include an assessment of plan costs and outcomes. The department states it will use cost and outcome data obtained from these reviews to formulate and implement additional cost efficient strategies. Also, the department established a workgroup that reviewed the information available on its statewide database and recommended changes to the management information system, including reports on district costs and outcomes. The department plans to implement the adopted recommendations in fiscal year 2000–01.

Finding #2: The department's method for evaluating the severity of clients' disabilities favors clients with certain disabilities.

The scoring instrument that the department now uses to identify those individuals whom its program must serve first favors people with learning and certain mental disabilities, so access to vocational services may be inequitable.

To ensure that the most severely disabled in all disability groups have equal access to services under order of selection, we recommended that the department modify its significance scale.

Department Action: Partial corrective action taken.

The department has proposed major revisions to its significance scale. The revisions have been presented to and received approval of the State Rehabilitation Council and disability advisory groups. The department, in conjunction with San Diego State University, tested the revised significant scale and determined it to be reliable and valid. Proposed regulations required to implement the revised significant scale are being finalized, and the department expected the revised significant scale to be implemented and in regulation by July 2001.

DEPARTMENT OF SOCIAL SERVICES

It Still Needs to Improve Its Oversight of County Child Welfare Services

REPORT NUMBER 2000-500, MAY 2000

We performed a follow-up audit to determine the extent to which the Department of Social Services (department) implemented the recommendations included in our January 1998 report, number 97103, titled *Kern County: Management Weaknesses at Critical Points in Its Child Protective Services Process May Also Be Pervasive Throughout the State*.

Specifically, we reviewed the timeliness and completeness of the department's compliance reviews of county child welfare services agencies. We also evaluated the department's efforts to track statewide child fatalities caused by maltreatment, and its efforts in analyzing this information to develop prevention strategies. Finally, we assessed the department's progress in developing and implementing assessment tools to aid caseworkers in making critical decisions regarding the welfare of children.

Finding #1: The department conducts compliance reviews as required, but is not promptly ensuring corrective action.

The department now conducts timely compliance reviews of county child welfare services programs; however, it is still slow to give counties written reports of their deficiencies and remiss in ensuring counties promptly submit corrective action plans (CAPs). These delays may extend the amount of time a county remains out of compliance with department regulations designed to ensure children are adequately protected.

We recommended that the department continue pursuing and implementing measures to reduce the amount of time it takes to issue compliance reports and to receive and respond to CAPs.

Department Action: Partial corrective action taken.

In its October 2000 response, the department stated that it continues to use the tracking tool it developed for compliance reports and CAPs to ensure these items are completed timely. It is also revising the CAP process to clarify what is expected from counties in order to facilitate their preparation of CAPs. It now immediately assigns corrective action specialists to provide technical assistance in developing and improving the quality of county CAPs. Finally, the department hired four new analysts to enhance its compliance review efforts.

Finding #2: The department has not fully implemented our recommendations to improve the quality of its county compliance reviews.

Although it implemented our recommendation to examine cases from county emergency response systems during its compliance reviews, the department does not always require corrective action when it notes deficiencies. It is important to review each county's emergency response system and to ensure problems are corrected because a system that is not working properly may prevent a county from responding quickly to allegations of abuse or neglect, leaving children at risk.

In addition, the department does not examine the administrative practices of child welfare services as part of its county compliance reviews. Because weak administration can hinder the delivery of key program services, the department is missing opportunities to better ensure children's health and safety.

We recommended that the department require counties to develop CAPs for all emergency response deficiencies noted during compliance reviews and that it review county administrative practices during compliance reviews.

Department Action: Partial corrective action taken.

The department reports that it implemented a requirement for CAPs for all emergency response deficiencies beginning in July 2000. Further, the department told us that it is working with the County Welfare Directors Association to develop a process for reviewing county administrative practices that will be consistent with reviews the federal government will be conducting.

Finding #3: The department should begin assessing child abuse and neglect-fatality data currently available.

The department does not yet analyze existing data on children's deaths from abuse and neglect. Until the department analyzes this data, it cannot identify potential systemic weaknesses in child welfare services or consider whether legislative or regulatory changes might prevent future deaths of children from abuse and neglect.

In addition, the department has not distributed procedures for counties to comply with Chapter 1012, Statutes of 1999, which requires counties to report all cases of child deaths suspected to be related to abuse or neglect through the child welfare services Case Management System (CMS). The reporting of all child deaths through the CMS would improve statewide data regarding the extent of these deaths.

We recommended that the department assess the data currently available regarding child fatalities from maltreatment and that it develop and disseminate procedures for counties to report all child deaths through CMS as soon as possible.

Department Action: Pending.

The department is exploring ways to improve the monitoring, analysis, and tracking of data on children who die from abuse and/or neglect in California. In addition, it is finalizing a procedure to facilitate the documentation on the CMS of all child deaths related to suspected maltreatment.

Finding #4: Although its Structured Decision-Making Project appears to have potential for statewide benefit, the department does not have plans to assess whether counties participating in the project achieve better outcomes for children and families than counties that are not participating.

The department continues to provide leadership for statewide child welfare services by implementing its Structured Decision-Making Project. Although this pilot project is just getting started, initial indicators suggest it can benefit all child welfare services. However, the department presently does not plan to assess whether counties participating in the pilot project achieve better outcomes for children and families than counties that are not participating. Without such a comparison, the department cannot easily confirm the project's benefits and advocate its expansion to all counties.

We recommended that the department conduct an outcome evaluation to determine if the pilot project results in better outcomes for children and families.

Department Action: Pending.

The department is continuing its review of data generated from the pilot project to evaluate its capacity to improve the decision-making capabilities of child welfare workers. The department is also continuing discussions regarding the possibility of hiring a contractor to conduct an outcome evaluation of the project. However, the department believes that such an evaluation should not be conducted before fiscal year 2002–03 in order to allow for a sufficient case sample size.

DEPARTMENT OF SOCIAL SERVICES

To Ensure Safe, Licensed Child Care Facilities, It Needs to More Diligently Assess Criminal Histories, Monitor Facilities, and Enforce Disciplinary Decisions

REPORT NUMBER 2000-102, AUGUST 2000

Audit Highlights . . .

As the State's agency for licensing and monitoring child care facilities, the Department of Social Services:

- ☑ *Has wide discretion for granting criminal history exemptions and allowing people who have committed crimes to care for or come in contact with children.*
- ☑ *Has allowed its staff to make exemption decisions with little or no management oversight.*
- ☑ *Should exercise more caution when granting criminal history exemptions.*
- ☑ *Does not always follow up on complaint investigations or perform required, timely facility evaluations.*
- ☑ *Imposes appropriate disciplinary actions against child care facility licensees but does not effectively enforce these actions once the decisions are made.*

The Joint Legislative Audit Committee requested that we assess the Department of Social Services' (Social Services) policies and practices for licensing and monitoring child care facilities.

Finding #1: Social Services has significant discretion and should use greater caution when issuing criminal history exemptions.

Social Services has broad statutory authority to grant exemptions to the law that prohibits anyone with a past criminal conviction from caring for children or residing in a licensed child care facility. In 1999 Social Services approved 95 percent of the exemption requests it received. Although people convicted of such crimes as murder or rape cannot qualify for an exemption, Social Services may consider individuals who have committed other crimes, even felonies like spousal battery and assault with a deadly weapon.

In early 2000 Social Services concluded that its exemption procedures were inadequate and its staff may have too much latitude in granting exemptions. Our review of 25 exemptions confirmed that its own policies contributed to poor decision making because Social Services:

- Allowed staff to grant exemptions with little or no management oversight.
- Did not sufficiently consider information other than conviction data or deem important an applicant's lack of honesty in filing for an exemption, before an exemption was granted.

We recommended that the Legislature determine whether Social Services' current level of discretion to exempt individuals with criminal histories is appropriate, consider pursuing laws that

automatically deny an exemption on a greater range of crimes, and consider expanding the variety of serious arrests Social Services may review during its exemption process.

We also recommended that Social Services continue following its new management review procedures of criminal exemptions involving felonies but also require management to periodically review and approve a representative sample of all other exemptions granted. Finally, Social Services should actively consider all available information, not just "rap sheets" when granting exemptions.

Legislative Action: Partial corrective action taken.

In September 2000, the governor signed Senate Bill 1992 (Chapter 819, Statutes of 2000). This bill, among other things, expanded the list of crimes for which Social Services cannot grant an exemption and added crimes to the serious arrest list.

Department Action: Corrective action taken.

In its final response to our audit recommendations, Social Services indicated that it continues to require supervisory review of all felony exemption cases. In addition, its supervisors are reviewing 10 percent of all other exemption requests. Finally, staff are actively considering all available information, not just rap sheets when deciding on an exemption request.

Finding #2: Social Services' criminal history checks are slow, sometimes incomplete, and its FBI background check procedures are questionable.

Social Services has some fixed timelines for processing criminal history exemptions; however, it is not always able to work within these timelines. Municipal agencies, such as courts and local law enforcement, contribute to Social Services' criminal history-exemption process but do not always provide information in a timely manner or may report incomplete criminal history data. Because access to licensed child care facilities pending a criminal history review differs between license holders (licensees) and facility employees, when Social Services delays granting an exemption it may impede a person's right to work or put children in the care of people who pose a threat to their safety.

We recommended that Social Services establish and meet its goal for notifying individuals that an exemption is needed, develop safeguards to help ensure that municipal agencies provide information promptly, and use its tracking system to identify cases that are not progressing to a reasonable, timely conclusion.

Department Action: Partial corrective action taken.

Social Services reported that it began piloting an automated case-management system in December 2000 to assist staff in tracking all background check activities. Tracking includes generating a notice to be mailed to individuals for whom a criminal history exemption is needed, and a tickler component reminding staff when certain documents or actions are due. Social Services stated that the system is 'on schedule,' but did not indicate an operational date.

Social Services stated that as it has no jurisdiction over municipal agencies, changes would require legislative action—and recent legislation did not pass. Nonetheless, our recommendation is still appropriate because Social Services could take steps to change its own processes to help ensure that municipal agencies are responsive to its requests for data.

The law states that individuals who declare they have not been convicted of crimes can start operating, working in, or residing in a child care facility while Social Services conducts an FBI check. For 9 of 11 individuals we reviewed, Social Services licensed or allowed them to operate, work in, or live in child care facilities without FBI checks even though these individuals disclosed criminal convictions. Social Services' interpretation of the law is to allow people who disclose criminal convictions to begin caring for children before going through the mandatory FBI check. Our interpretation differed as we believe the law means that Social Services cannot authorize any individual who discloses criminal convictions to begin caring for children until an FBI check is complete. Social Services' actions could leave children in the hands of individuals whose criminal histories make them unfit to supervise children.

According to the deputy director for the Community Care Licensing Division, Social Services does not believe the Legislature intended to delay licensure or employment pending individuals' FBI checks. And, Social Services contends that although designed as an additional safeguard, the FBI checks have not proved more accurate or up-to-date than information the Department of Justice (Justice)

provides through its records review. Nevertheless, we believe that children are best protected when Social Services conducts FBI checks on individuals before they come in contact with children.

We recommended that the Legislature clarify the existing FBI check requirements to specify whether an individual can have contact with children pending an FBI check.

We also recommended that Social Services, to implement the FBI record-checking requirement in accordance with the law, reevaluate its current FBI records review policies and procedures and properly apply the requirements that allow individuals to work with or be in close proximity to children while their FBI check is pending.

Legislative Action: Unknown.

We are unaware of any legislative action taken to implement these recommendations.

Department Action: Corrective action taken.

With regard to FBI checks, Social Services noted that it reviewed its processes and found them to be in accordance with the law and legislative intent. In its final response to our audit recommendations, Social Services stated that in April 2001 Justice began sending FBI check information to Social Services electronically. Social Services previously stated that it hoped electronic submission of these records would further improve the accuracy and responsiveness of the process.

Finding #3: Justice's process for reporting subsequent criminal activity is flawed.

For four of nine cases we reviewed, Justice failed to notify Social Services when an individual it previously approved for access to a child care facility was convicted of a crime or arrested for certain statutorily defined crimes. Justice's lack of a method for tracking new arrest and conviction information contributed to its failure to notify Social Services as required. As a result, Social Services cannot monitor individuals who continue criminal activity after their criminal histories are initially reviewed and cleared, which may compromise the safety of children in care.

We recommended that Justice establish a system to track notices sent to Social Services about individuals previously granted access to child care facilities who commit additional crimes.

Department Action: Partial corrective action taken.

In the short run, Justice stated that by December 2001 it will modify the work area to enable staff to work and track in chronological order individuals previously granted access to child care facilities who commit additional crimes. In addition, in November 2001, Justice added an evening shift to its Record Information and Services Program to process subsequent arrest information. In the long run, Justice is redesigning its Automated Criminal History System so it can process subsequent arrest notifications electronically. Justice indicated the target date is July 2003.

Finding #4: Parents lack information about caregivers' criminal history exemptions.

Neither Social Services nor the caregiver are required to disclose to parents crimes the caregiver committed or that Social Services has granted a criminal history exemption. State law prohibits Social Services from disclosing the contents of an individual's rap sheet; however, during the audit Social Services acknowledged it could disclose to the public its exemption decisions and to whom exemptions were granted. However, Social Services has never directed licensees to disclose criminal history exemptions, believing that doing so may expose both it and the caregiver to legal liability. Until Social Services ensures that disclosures are made, parents will not receive critical information they need to make informed child care choices.

We recommended that Social Services, working with the Legislature, require disclosure of criminal history exemptions. Further, the two parties should determine the types of criminal histories and lengths of time this requirement should apply to, such as disclosing for five years an exemption received for certain convictions and serious arrests.

Legislative Action: Unknown.

The Legislature passed Assembly Bill 2431 in August 2000, which would have added Health and Safety Code Section 1596.8775, allowing the public to view documents Social Services sent to a licensee regarding criminal background check exemptions. However, the governor vetoed this legislation and we are unaware of any subsequent legislative action.

Department Action: Partial corrective action taken.

Social Services reported that, along with Justice, it studied California law and determined that making criminal history exemptions public information would violate an individual's right to privacy. Social Services is currently litigating a Public Records Act request regarding past criminal history exemptions it has granted. The lower court upheld Social Services' decision; however, an appeal is pending and that decision will provide further direction in this area.

Finding #5: Social Services has been lax in ensuring complaints against child care facilities are corrected and that required periodic monitoring is performed.

Although Social Services appears to effectively investigate complaints it receives regarding child care facilities, it does not consistently pursue substantiated complaints to ensure that problems are corrected. For 14 substantiated complaints we reviewed, in almost 40 percent of these cases, Social Services could not demonstrate that the problem at the facility was corrected. Because Social Services does not always perform the necessary follow-up procedures on substantiated complaints, it cannot guarantee that child care facility licensees comply with the laws and regulations and provide safe and healthy environments for children.

Social Services also does not always meet its requirement to evaluate each child care center annually and each child care home every three years. Frequently, facilities are inspected long past the deadline, and sometimes not at all. Of 91 evaluations (46 child care centers and 45 child care homes) we reviewed, Social Services failed to perform 21 of them on time—6 of the 21 were performed more than seven months late. Evaluations that are significantly late prohibit Social Services from ensuring that licensees are operating properly and caring for the children entrusted to them.

We recommended that Social Services:

- Review and modify its complaints processing procedures so that all necessary complaint follow-ups occur.
- Conduct facility evaluations as required within the timelines established for both child care centers and child care homes.
- Track and monitor evaluations that are not performed on time until the evaluations are conducted.

Department Action: Partial corrective action taken.

In its final response to us in August 2001, Social Services stated that a work group was drafting changes to an existing supervisory handbook. The handbook was expected to have been finalized by December 2001. Social Services is also planning a training program that will focus on more effectively managing and monitoring field staff activities. Social Services planned to provide the training in early 2002.

Regarding facilities evaluations, Social Services reported it has modified its tracking system to display facility visit histories to more accurately track due and overdue visits. However, Social Services believes staff vacancies and workload increases affect its ability to complete prompt evaluations.

Finding #6: Social Services' oversight of its staff and district operations is insufficient, and it does not consistently monitor county licensing functions.

Other than overseeing new analysts for the first three to six months on the job, Social Services lacked a systematic process for supervisors to ensure that analysts continually make sound decisions and appropriately enforce licensing regulations. Consequently, Social Services has little assurance that analysts are effectively administering the child care facility licensing program.

We recommended that Social Services:

- Establish standards requiring district offices to periodically review evaluation reports analysts prepare.

- Make certain that each district office is scheduling and performing its quality-enhancement process evaluations as required.

Department Action: Corrective action taken.

Social Services reported that it is requiring the district offices to submit to their regional office an annual report of all completed quality-enhancement process evaluations. The district offices are to provide a justification in the reports if evaluations are not completed or are delayed. Social Services believes this will serve to address or eliminate the findings regarding insufficient staff oversight.

Social Services' regional offices are responsible for monitoring district office operations. However, Social Services has failed to establish policies and procedures or standards to direct its regional offices in their oversight role. As a result, the regional offices do not effectively or consistently monitor the district offices' licensing activities, and Social Services cannot ensure that its licensing activities are conducted in accordance with state laws and regulations.

We recommended that Social Services establish policies and procedures to ensure that regional offices periodically and consistently assess district offices' operations.

Department Action: Partial corrective action taken.

Social Services is awaiting approval for a divisionwide reorganization and hopes to create a quality control unit that will help ensure regional offices periodically and consistently assess district offices' operations. Additionally, in December 2001, the department expected to begin piloting a systems review program designed to evaluate district office operations. Upon completing the pilot, Social Services anticipated conducting statewide periodic district office reviews. However, Social Services did not indicate a time frame for completing the pilot and full program implementation.

Social Services contracts with 10 counties, allowing them to license and monitor child care homes; 9 of these counties are within its northern region. As outlined in its agreements with the counties, Social Services is responsible for inspecting, reviewing, and monitoring each county's activities. However, over an eight-year period from 1991 to 1999, the northern region reviewed only 3 of 9 county licensing programs under its direct supervision. Because Social Services lacks a schedule for periodically and consistently monitoring the counties' licensing programs, it cannot ensure that county programs are operating effectively and may be allowing deficiencies within these programs to persist.

We recommended that Social Services develop and maintain a schedule to periodically review each county's child care facility licensing operations.

Department Action: Corrective action taken.

Social Services reported in its final response to our audit recommendations that it had developed a schedule to periodically review each of the 10 counties authorized to perform child care licensing functions and had visited those scheduled. It further stated it will make visits more often if necessary, and follow-up visits will be made to ensure the counties correct any deficiencies.

Finding #7: Social Services should take further steps to process legal actions more quickly.

In April 1998 Social Services set a goal of six months for filing pleadings for all cases received. For 33 cases reviewed that were filed after April 1998, only 3 cases took more than six months to file the pleadings, most took less than four months. Although our report acknowledged that the most serious cases should be processed first—which is what Social Services reports that it attempts to do—we question whether the six-month goal for filing cases is short enough. Social Services takes disciplinary action against a licensee who is not appropriately caring for children; a six-month goal for taking action seems imprudent, especially when children are left in the licensee's care pending the outcome of the disciplinary process.

We recommended that Social Services reassess its goal of filing a case pleading within six months of receiving a request for legal action and strive to shorten it. Once it sets a more appropriate time goal for processing legal actions, it should ensure that its processing goals for legal cases are met.

Department Action: Partial corrective action taken.

Social Services states that the most serious cases are filed first and that procedures exist for expedited pleadings when requested by district office staff. Further, it believes its ability to meet a shorter turnaround period for filing case pleadings is constrained by the increased numbers of administrative actions requested. However, Social Services reports that it recently hired 10 additional legal staff and reorganized its enforcement unit, which will ensure legal case processing goals are met.

Finding #8: Social Services' enforcement of legal actions is weak.

Social Services does not always consistently and diligently enforce decisions regarding license revocation and individual exclusions by appropriately following up to ensure the child care facility is closed or the excluded individual is barred from the facility. In addition, it does not effectively ensure that all licensees on probation comply with the settlement terms. These weaknesses are due primarily to Social Services' failure to provide adequate guidance to district offices, which are responsible for enforcing legal decisions. As a result, Social Services does not always make certain that serious and potentially dangerous conditions in child care facilities are remedied.

We recommended that Social Services establish policies to guide district offices on:

- Enforcing all license revocations and facility exclusion decisions promptly, effectively, and consistently.
- Creating formal plans to monitor licensees placed on probation as a result of legal actions.

Department Action: Corrective action taken.

Social Services reported that in February 2001 it distributed to staff revised procedures for facility closures and following up to verify that an individual excluded from a facility is not present. At the same time, Social Services provided staff with policies and procedures to use in monitoring probationary facilities.

TECHNOLOGY, TRADE AND COMMERCE AGENCY

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

REPORT NUMBER 2001-115, DECEMBER 2001

Audit Highlights . . .

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

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

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

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

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

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

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

Despite starting two agency-wide strategic planning processes since 1996, the agency still does not have an agency-wide strategic plan. It has reverted to using individual program plans, which are often incomplete and vary widely because the agency has not set standards for planning. For example, many program plans do not include goals for all significant aspects of their mission or vision statements or for outcomes included in external reports. In some cases, these plans do not include any outcomes goals, thus lacking a focus on the benefits that their programs are trying to achieve. In addition, some plans do not include quantified targets for their goals, and some do not include targets that challenge performance. Moreover, internal and external reports on program accomplishments rarely compare targets that do exist with actual results, reducing accountability within the agency and to stakeholders such as the Legislature. Finally, no programs we reviewed developed plans covering five or more years, and many programs did not consider

opportunities or threats from their external environment in establishing their plans, diminishing their ability to position themselves for maximum effectiveness. By de-emphasizing strategic planning, the agency misses the benefits of a broad, outcome-oriented approach, which is vital to integrating diverse programs, allocating resources to efforts that best advance overall goals, and demonstrating the value of the agency's activities.

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

Agency Action: Pending.

The agency said that it would review and update its 1997 strategic plan and incorporate elements we recommended, where appropriate. It also agreed to review the format of program plans to add elements we recommended. The agency questioned whether a biennial report to the Legislature on its progress in implementing a strategic approach is necessary.

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

Lengthy vacancies for appointed positions at some of the International Division units weakened planning and operations. Vacancies at foreign offices, where all positions are appointed, resulted in a lack of plans and focus during two recent years. For instance, almost half of the positions at the Mexico office were vacant for about a year or more, causing the office to function at a minimal level. A review of appointments made to all foreign offices since January 1999 showed that, on average, positions were vacant 10.5 months with the agency taking nearly 9 months to

submit nominations. Similarly, the commission lacked a chairperson and did not meet between October 1998 and March 2000. Subsequently, the commission has provided little policy direction. It is now considering initiating its first study since 1998.

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

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Agency Action: None.

The agency did not indicate that it would change its processes for nominating persons to positions in its International Division. It contends that it has always given its highest priority to nominating persons to its appointed management positions. Further, it stated that it cannot commit to fill lower level positions before managers are appointed since it questions whether this is a sound management principle.

Commission Action: Pending.

The commission is revising its bylaws to address the issue of operating when a chairperson is not yet appointed.

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

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

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

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Agency Action: Pending.

The agency plans to contact the Employment Development Department to obtain data to verify job estimates on a sample basis. The agency did not, however, say how it would address the recommendation to follow up on client estimates.

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

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

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

Agency Action: Pending.

The agency said that the International Division is committed to increasing the level of coordination with other entities, but it did not indicate what specific actions it plans to undertake.

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

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

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

Legislative Action: Unknown.

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

Although programs lack formal feedback mechanisms and targets for customer satisfaction, our survey of a sample of customers for seven Economic Development Division programs found that customer service rankings for five programs were above average. Nevertheless, the survey results indicated room for improvement, with some customers noting specific concerns. Customers' suggestions included improving the timeliness of information, being more proactive in obtaining feedback, and improving the transition process during changes in administration. By using formal methods, such as goals and targets for customer satisfaction

and customer satisfaction surveys, programs would be able to measure their performance and more reliably determine customers' unmet needs and expectations.

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

Agency Action: Pending.

The agency agreed with the importance of gauging customer satisfaction and committed to incorporating such measurements into work plans, as resources allow.

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

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

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

Agency Action: Pending.

The agency said that it is committed to developing and sustaining a positive and productive working relationship with the financial development corporations. Additionally, it said that it will take steps to develop a more comprehensive statewide marketing effort, but it did not discuss other actions it would take to implement this recommendation.

DEPARTMENT OF TRANSPORTATION

Investigations of Improper Activities by State Employees, Report I2001-1

Audit Highlights . . .

A California Department of Transportation (Caltrans) employee:

- ☑ *Had a conflict of interest when he participated in making Caltrans decisions that benefited a company owned by his wife.*
- ☑ *Misused his state position to influence Caltrans contractors and other private businesses to do business with his wife's company.*
- ☑ *Used state resources to solicit work for his private consulting business.*

Caltrans:

- ☑ *Did not require this employee, nor others in similar classifications, to file annual statements of economic interest to assist in identifying and preventing conflicts of interest.*

ALLEGATION I980141, APRIL 2001

We investigated and substantiated that an employee of the California Department of Transportation (Caltrans) violated conflict-of-interest laws and engaged in incompatible activities. In addition, Caltrans failed to identify and prevent conflicts of interest. Specifically:

Finding #1: The employee participated in a governmental decision that benefited his wife's company.

The employee, acting within the authority of his position, but contrary to state law, recommended that the erosion control product sold by his wife's company be used on a Caltrans project, resulting in state payments to her company.

Finding #2: The employee's actions created at least the perception of more conflicts of interest.

At least 35 contractors, subcontractors, or vendors on Caltrans projects also purchased products from the company owned by the employee's wife. The employee's state position provided him with the opportunity to influence contract specifications and wield considerable power over a substantial number of contractors and subcontractors, creating at least the perception of more conflicts of interest.

Finding #3: The employee offered to use his influence to benefit other companies and potentially himself.

The employee told a business owner that he could use his Caltrans position to make sure that a product he wanted to manufacture and sell with the owner would be specified for projects throughout the State. The employee violated the prohibition against incompatible activities by offering to use the influence of his state position in ways that would financially benefit not only contractors but possibly himself. Another company's Web site contained a quote from the employee, who was identified as a Caltrans employee, which could be interpreted as an endorsement.

Finding #4: Contractors believe the employee used his authority to influence and intimidate them and others.

Contractors told us that they believed the employee had used his state position to compel, intimidate, or threaten contractors to get them to use particular materials produced by his wife's company. In addition, the employee's favoritism toward some vendors was not only discouraging for the competition but also might have resulted in Caltrans paying higher prices.

Finding #5: The employee created confusion by representing both Caltrans and his wife's company.

The employee represented both Caltrans and his wife's company at professional conferences, creating confusion about whose interests he was representing. The fact that the employee both works for Caltrans and represents his wife's company could be interpreted as a Caltrans endorsement, creating an unfair advantage for the company.

Finding #6: Caltrans conducted three investigations of possible conflicts of interest involving the employee but did not take appropriate action.

Caltrans knew the employee wrote contract specifications and tried to use his influence in other ways that benefited his wife's company. Caltrans also knew the employee solicited private consulting work on state time. Although Caltrans issued instructions for conduct to the employee, he violated the instructions and continued to use Caltrans information to his advantage by assisting his wife's company. Individuals in the erosion control industry said that Caltrans' inaction sent a clear signal that this is what passes for acceptable behavior by state employees.

Finding #7: Caltrans has not established adequate controls over conflicts of interest.

Caltrans did not require the employee, or other employees in similar positions of influence, to disclose their financial interests. As a result, Caltrans may be unaware of employees' financial interests that could conflict with their responsibilities as state employees.

Caltrans Action: Partial corrective action taken.

In January 2001 Caltrans told us it reassigned the employee to a job where he no longer had responsibilities that could constitute a conflict of interest. Caltrans told us it issued revised policies on conflicts of interest and incompatible activities.

Caltrans also told us it had suspended the employee for 45 days without pay. However, we discovered that this information was incorrect. After serving the employee with notice of a 60-day suspension without pay, the employee appealed and a formal agreement between the parties stipulated a 30-day suspension without pay. Although Caltrans says that the employee did not report to work for 30 working days per the agreement, due to a Caltrans processing error, the employee continued to receive his full salary and failed to notify Caltrans of this fact.

After we brought this matter to its attention in October 2001, Caltrans notified the employee that he would have to repay over $7,300 and has given him a number of repayment options. Since Caltrans made the error, it does not plan to take any further action against the employee for failing to disclose the fact that he continued to receive his full salary and benefits during his suspension. It is unclear whether Caltrans would have discovered its error or whether the employee would have ever brought it to Caltrans' attention. Nevertheless, Caltrans' error essentially led to the employee receiving an interest free loan.

DEPARTMENT OF TRANSPORTATION

Inadequate Strategic Planning Has Left the State Route 710 Historic Properties Rehabilitation Project Nearly Without Funds and Less Than Half Finished

REPORT NUMBER 2000-127, DECEMBER 2000

Audit Highlights . . .

Our review of the Department of Transportation's (department) State Route 710 historic properties rehabilitation project revealed that the department:

- ☑ *Did not use a strategic approach to ensure it would complete the project within the authorized funding.*
- ☑ *Completed the rehabilitation of less than half of the properties at an average cost of more than $400,000 each, and has nearly exhausted the funding it received.*
- ☑ *Cannot demonstrate that it used the most cost-effective methods when performing work and that it exercised the discretion allowed by federal guidelines.*
- ☑ *Relied on an undocumented process to ensure work performed complied with applicable codes, and thus has limited assurance that all relevant code requirements were considered and applied properly.*

We reviewed the Department of Transportation's (department) expenditure of state funds to rehabilitate historic properties along the proposed State Route 710 corridor. Our review found the following problems concerning the department's historic properties rehabilitation project:

Finding #1: The department did not adopt a strategic approach to ensure that it would complete the project within authorized funding.

The plan the department presented to the California Transportation Commission (CTC) in November 1996, when it requested $16 million to rehabilitate 81 historic properties, did not adequately consider or address all relevant information. The estimates it used in support of its funding request were neither well developed nor feasible. Further, after receiving the CTC's approval for the additional funds, the department did not manage the project as though $16 million was all the funding it would have to complete the 81 properties. Even when it became clear early in the project that funding was not adequate, the department did not raise this as a concern to the CTC or sufficiently explore other alternatives. In fact, it waited at least two years before it informed the CTC of its financial problems. As a result of not using a strategic approach, the department has rehabilitated only 39 of the 92 historic properties it currently owns and has nearly exhausted the $19.4 million in funding it received to complete the entire project.

We recommended that in the future when faced with similar projects with funding constraints, the department should ensure that it assesses the needs of the entire project and prioritizes those needs. In addition, we recommended that the department notify funding authorities promptly when it becomes aware that existing funding will not be sufficient to meet project goals.

Department Action: Pending.

The department agreed to implement our recommendations on future projects that it undertakes.

Finding #2: The department cannot demonstrate that it exercised the discretion allowed by federal guidelines to achieve the most cost-effective approach to its historic properties rehabilitation project.

Although the department appears to have implemented certain cost-reduction measures, it could not demonstrate that it used the most cost-effective methods when performing work on the project. It is especially important for the department to be able to show that it was cost-effective to justify the significant amounts it spent rehabilitating its historic properties. On average, the department spent more than $400,000 per property for those it completed. However, the department cannot demonstrate that it implemented a systematic approach for the project to ensure that it fully explored its options or exercised discretion allowed by federal guidelines, such as focusing rehabilitation efforts on the features that are most important in contributing to the overall significance of the property. As a result of these shortcomings, the department lacks assurance that it performed work on the project in the most cost-effective manner.

We recommended that to ensure any future rehabilitation work that the department performs is as cost-effective as possible, the department should develop revised cost estimates for each property using condition assessments that assist the department in prioritizing its rehabilitation efforts. The department should focus its efforts on those historic features that are most important in contributing to the overall significance of the property and consult with the Office of Historic Preservation to ensure that it takes advantage of the flexibility allowed by federal guidelines. In addition, it should consider the technical and economic feasibility of planned work when determining whether it has considered the least costly yet acceptable alternatives.

Department Action: Partial corrective action taken.

The department reports that condition assessment reports and related cost estimates have been completed for 7 of the 48 historic properties not yet rehabilitated. As part of the condition assessment process for each property, character-defining features are identified and prioritized. Additionally, the Office

of Historic Preservation reviews each condition assessment report. The department's goal is to have all of the condition assessment reports completed by December 2002.

Finding #3: The department's failure to consider long-range rehabilitation plans seems questionable.

When it requested federal participation in the State Route 710 extension project, the department proposed to the Federal Highway Administration millions of dollars in mitigation and rehabilitation efforts to minimize the adverse effects to the historic properties along the route. However, the department did not consider this as part of its planning process for the current historic properties rehabilitation project. The current rehabilitation project uses only state funds, but the extension project and subsequent rehabilitation will be funded primarily with federal funds. We question why the department would not have factored these future plans for rehabilitation into the decisions being made for the current rehabilitation project. Because it did not do so, the department lacks assurance that it made the most appropriate decisions on its current project and that it maximized the use of federal funds. Further, it does not appear as though the department was always clear with the CTC about its future mitigation plans when requesting state funds for the current project. Disclosure of the department's long-range plans and the impact of future federal funding is important information for the CTC to consider when it makes funding decisions.

We recommended that the department consider how future rehabilitation work to be performed as part of the department's long-range mitigation plans for the freeway will impact the proposed work.

➲ ***Department Action: Pending.***

The department states that it notes the proposed disposition of the historic properties under the current freeway alignment on the condition assessment reports it prepares. It further states that this information will be taken into consideration concerning any future work. However, the department did not otherwise address how it plans to consider the impacts future rehabilitation work to be performed as part of the department's long-range mitigation plans will have on the proposed work on the historic properties rehabilitation project.

Finding #4: The department did not consider expected selling prices when determining how much to spend performing work on each property.

All the historic properties acquired for the State Route 710 corridor will eventually be sold. However, the department did not perform any analyses to determine a reasonable amount of funds to spend on rehabilitation costs for the properties based on the earnings it could expect from their sale once they were declared excess property. Given that the department had discretion regarding the extent of work performed on the properties, the expected selling prices for the properties would have been useful information to consider when setting a budget for work to be performed.

We recommended that the department take into account that the properties will ultimately be sold, some at less than fair market value, when determining to what extent the remaining historic properties should be rehabilitated.

Department Action: Pending.

The department reports that it will take this information into consideration with regard to any future work performed. However, it did not address the extent to which it considered this information when preparing the seven cost estimates that have been completed.

Finding #5: Although the department is proposing options for vacating and preserving its historic properties, certain concerns need to be addressed.

In response to the department's request for additional funding in March 2000, the CTC asked the department to develop alternatives for minimizing costs. The department prepared two alternative plans based on the mothballing preservation treatment approach prescribed by the Secretary of the Interior. However, mothballing is intended to be only a temporary measure, which is of concern because the department does not know how long it needs to maintain the properties. Further, we noted some specific concerns regarding the department's mothballing proposals. For example, the department's mothballing proposals do not address providing adequate ventilation, although this is considered to be one of the highest priorities according to federal guidelines. Also, the department did not consult with historical experts, including the Office of Historic Preservation, to ensure that all significant features will be stabilized and maintained. As a result of the various shortcomings we noted, the department cannot ensure that it is presenting

an accurate estimate of the level of funding necessary for mothballing, or that mothballing is appropriate under the circumstances.

We recommended that if it pursues either of its mothballing proposals, the department should ensure compliance with federal guidelines, and it should obtain approval from the Office of Historic Preservation as to their propriety.

Department Action: Pending.

The department states that as of this time, the mothballing option has not been selected as the proposed treatment for the properties. According to the department, if mothballing is selected, it will take over one year to obtain appropriate environmental clearance. However, the department reports that the Office of Historic Preservation, during preliminary consultations, stated that mothballing may have an adverse effect on the historic districts and there may be other environmental impacts.

Finding #6: The department relied on the Department of General Services' (General Services) process, but did not require documentation to ensure the project complied with applicable codes.

The department relied on its contractor, General Services, to ensure that the work on its State Route 710 historic properties rehabilitation project complied with applicable codes. General Services appears to have a process designed to ensure that it considers and applies codes relevant to the project. However, General Services did not document the key judgments it made in carrying out its process, such as identifying the specific code requirements applicable to this project because it is not its standard practice to do so. Additionally, it did not document its process for ensuring that code requirements were applied properly. Because the department neither required General Services to document its process nor conducted its own review to ensure compliance with codes, the department has limited assurance that staff considered and applied properly all relevant code requirements when performing work on the project. In fact, neither General Services nor the department considered the State code section that requires the department to conform to local building codes that were in effect at the time it acquired its properties.

We recommended that to ensure future work on this or any similar projects complies with all applicable codes, the department should develop a process to identify and evaluate all code requirements related to the project, including evaluating local codes to determine whether they apply, and if so, whether they conflict with applicable state codes. Additionally, the department should ensure that it can demonstrate it has considered and applied properly the relevant code requirements.

Department Action: Partial corrective action taken.

The department reports that a checklist has been developed to identify local code violations as well as decent, safe, and sanitary standards and that it is working well. However, the department points out that it is important to note that property use is an important factor in determining the level of work required on the properties.

Finding #7: Questions have been raised about the project's compliance with building codes.

Tenants raised concerns with local building inspectors that rehabilitation work on the project did not conform to codes. Local building inspectors inspected three of the properties that had been rehabilitated and discovered several violations of the city code and the Uniform Building Code. We questioned General Services about some of these apparent violations. Although General Services' explanations appear reasonable, they raise questions about how well the department has communicated with the tenants and local authorities regarding what they should expect from the department's rehabilitation work.

Both the department and General Services have indicated that they do not believe current local codes apply to the rehabilitation work. It seems apparent, however, that both tenants and local building inspectors expected these rehabilitated properties to meet local building codes. This gap between the community's expectation that the work would comply with local building codes and the department's assertion that those codes do not apply to the rehabilitation project illustrates a need for the department to provide better information about what the community can expect in rehabilitated historical properties and why.

We recommended that the department look for methods that will provide the community with better information about what they can expect in rehabilitated historic properties.

➲ ***Department Action: Pending.***

The department agreed to implement our recommendation when it initially responded to our audit. However, it did not report the status of this recommendation in its one-year response to us.

DEPARTMENT OF TRANSPORTATION

Its Seismic Retrofit Expenditures Generally Comply With the Bond Act, and It Has Begun to Reimburse the Interim Funding for Fiscal Years 1994–95 and 1995–96

REPORT NUMBER 2001-010, DECEMBER 2001

In March 1996 California voters approved the Seismic Retrofit Bond Act (Bond Act), which authorized the State to sell $2 billion in general obligation bonds to reconstruct, replace, or retrofit state-owned highways and bridges. Legislation passed in 1995 requires the Bureau of State Audits to ensure that projects funded by the Bond Act are consistent with that measure's purposes. This is the sixth in a series of annual reports on the Department of Transportation's (department) revenues and expenditures authorized by the Bond Act.

Overall, the department has moved forward toward its goal of retrofitting more than 1,150 state-owned highway bridges and 7 state-owned toll bridges. As of June 30, 2001, the department has spent $1.49 billion for retrofit projects and had completed work on 98.1 percent of the highway bridges and 2 of the 7 toll bridges. In addition, as required by the Bond Act, the department has begun to reimburse other accounts for interim funding obtained during fiscal years 1994–95 and 1995–96. During those years, the State Highway Account (highway account) and the Consolidated Toll Bridge Fund (toll bridge fund) provided a total of $114 million for the retrofitting of California's bridges. As of June 30, 2001, the department had reimbursed the highway account $26.3 million and it intends to fully reimburse both the highway account and the toll bridge fund before the Bond Act expires in 2005.

Finding #1: The department inappropriately charged some expenditures to seismic retrofit projects.

In general, the department has done a good job of ensuring that its seismic retrofit projects meet the criteria for funding outlined by the Bond Act. However, we found two instances in which the department charged expenditures to the Bond Act that were not eligible for such funding. In both instances, department staff stated that they were unaware of the department's policies requiring the

allocation of certain types of facility costs. As a result, the staff inappropriately charged approximately $6,800 for a lease payment and a repair bill entirely to seismic projects rather than allocating the amount among seismic and nonseismic projects that benefited from the expenditure.

To ensure that Bond Act proceeds are used only to pay for eligible expenditures under the Bond Act, we recommended that the department direct its staff to follow its policy of allocating facility costs among all projects benefiting from the expenditure.

Department Action: Corrective action pending.

The department agrees with the report and recommendation and states that it is taking steps to correct the identified problems.

DEPARTMENT OF TRANSPORTATION

Has Improved Its Process for Issuing Permits for Oversize Trucks, but More Can Be Done

REPORT NUMBER 99141, MAY 2000

Audit Highlights . . .

Our review of the Department of Transportation's (Caltrans) process for issuing permits disclosed:

- ☑ *Roadway changes are not always promptly communicated to the permits branch.*
- ☑ *Hundreds of field personnel report roadway changes to only two regional liaisons.*
- ☑ *Policies and procedures for reporting roadway changes differ among reporting units.*
- ☑ *Caltrans is taking steps to improve communication of roadway information.*
- ☑ *The process for writing permits is inefficient, labor-intensive, and susceptible to human error.*

We evaluated the Department of Transportation's (Caltrans) process for approving travel routes and is suing permits that allow oversize trucks to move along specified routes on the state highway system. We found the following deficiencies:

Finding #1: Caltrans' reporting structure has too many individuals reporting to too few liaisons.

Caltrans has too many personnel reporting changes in road conditions via e-mail, fax, and phone to only two individuals working as regional liaisons who have no authority to enforce reporting requirements. The permits branch relies on other Caltrans units—primarily the Construction, Maintenance, and Traffic Operations programs and the Office of Structures Maintenance and Investigations—to provide the required data and information for the routing database. At any given time, hundreds of individuals can be involved in projects requiring them to report changes to only two regional liaisons who have to evaluate all of the changes and update the database promptly so that permit writers have the most current information.

We recommended that Caltrans designate district staff to coordinate communication between the permits branch and personnel working in the field. Caltrans should require communication coordinators to work with the regional liaisons to develop a standard reporting format.

Department Action: Partial corrective action taken.

As of May 11, 2001, Caltrans hired nine truck services managers who serve as a focal point for reporting roadway changes throughout the 12 districts to the two regional liaisons.

Finding #2: Caltrans lacks uniform policies and procedures for reporting roadway changes.

The problem of poor communication of roadway changes is exacerbated by the fact that each of the reporting units—Construction, Maintenance, Traffic Operations and Structures Maintenance and Investigations—has its own policies and procedures governing the reporting of roadway change information to the permits branch. These policies are not uniform and do not always specify who is responsible for reporting roadway changes.

We recommended that Caltrans ensure that its policies clearly and consistently specify the types of roadway information that must be reported to the permits branch, and clearly communicate its policies and procedures to all responsible parties.

Department Action: Corrective action taken.

In July 2000 Caltrans reported that it issued a high-level policy directive that defines roles and responsibilities of various functional areas and various Caltrans functional program policies to strengthen reporting of roadway policies. In addition, Caltrans has contracted with a fax service provider to notify annual permit holders of highway changes.

Finding #3: Programs that report roadway changes have not always followed the policy for reporting such changes.

The procedures for reporting temporary and permanent clearance changes clearly state that those responsible for reporting should notify the regional liaison 15 days in advance. However, those responsible sometimes report these changes to a district traffic manager, but do not report them to the regional liaison. Regional liaisons must gather information from other sources and do not always have enough lead time to update the routing database and ensure that permits are issued for appropriate travel routes.

We recommended that Caltrans establish a process and designate a position with authority to enforce the reporting policies. If personnel do not adhere to the policies and procedures, Caltrans should tie reporting to performance evaluations.

Department Action: Partial corrective action taken.

Caltrans' new truck services managers will play a key role in implementing the new policy, described in the response to Finding #2, that holds accountable personnel responsible for reporting roadway changes.

Finding #4: Caltrans' current permit-writing process is labor-intensive and susceptible to error.

The current permit-writing process requires permit writers to manually process and review most permits by using maps and a roadway information database. This process is time-consuming, and it increases the risk of routing errors from transcription mistakes during the recording process or from a driver misreading an illegible permit. Another labor-intensive aspect of the current system is the practice of double-checking all overheight permits because the system does not have electronic controls that prevent the issuance of erroneous permits. Although this practice reduces the likelihood that Caltrans will contribute to accidents, performing this function manually is an inefficient and costly use of resources.

We recommended that Caltrans develop an automated routing system. If its current request for an automated routing system is not approved, Caltrans should seek approval again in the next budget cycle. In its new request, Caltrans should include an analysis of its staffing requirements and should also identify what the funding source would be.

Department Action: Partial corrective action taken.

Caltrans has received approval for funding a semi-automated routing system and has selected a vendor who will design and implement the new semi-automated routing system. Caltrans plans to have a new system operational by September 2002. Caltrans previously reported that its new system should be operational by April 2002, but several factors delayed the vendor selection process, causing Caltrans to revise its timeline for implementing the new system.

Finding #5: Caltrans does not collect adequate data on permit errors.

Caltrans does not track the number of roadway changes that were reported after the fact by truck drivers, the public, or other Caltrans employees; nor does it track changes that were reported late by those responsible. Moreover, Caltrans' current computer system does not allow it to identify all the erroneous permits and related incidents that may have resulted from late or unreported changes.

We recommended that Caltrans track and compile statistics on permit errors and use the information to identify problem areas.

Department Action: Pending.

Caltrans will incorporate the ability to track and compile statistics on permit errors into its new automated system. Caltrans will use this information to identify and address problem areas. Currently, Caltrans addresses permit errors on a case-by-case basis as it becomes aware that such a problem exists.

Finding #6: Caltrans does not enforce adequate, standardized procedures for requesting and writing permits.

Caltrans is not actively enforcing its policy of requiring permit applicants to use its standard application forms. Mistakes in permits can arise because Caltrans accepts modified permit application forms from its customers. Differences in these forms make them more difficult for permit writers to review. Further, Caltrans does not have standardized procedures for permit writers to use when issuing permits. As a result, drivers and other permit writers may have difficulty understanding permit instructions.

We recommended that Caltrans require that customers use the standard permit application form. We also recommended that Caltrans develop a standard format for permit writing.

Department Action: Pending.

Caltrans currently requires all of its customers who do not use its Web-based permit system to use its standard permit application form. However, beginning in early 2001, Caltrans planned to require all of its customers to use the same application form. In addition, Caltrans' new automated system will produce permits using a standard format.

Finding #7: Caltrans does not provide enough training for its new permit writers, nor does it provide formal ongoing training or a refresher course for its experienced staff.

Caltrans does not train new permit writers in the use of pilot car maps, standard terminology for writing a permit, and the routing database. Pilot car maps help a permit writer determine when a pilot car is needed. In addition, not all permit writers use the same abbreviations and wording to describe an approved route on a permit. Consequently, drivers and even other permit writers may have difficulty understanding routing instructions. Training will become even more important for the permit writers if Caltrans' new routing system is approved.

We recommended that Caltrans expand training for new permit writers to include instruction in standardized permit writing, use of pilot car maps, and use of the routing database, and develop an ongoing training program for experienced permit writers. In addition, Caltrans should assess the training needs of experienced permit writers and develop an ongoing training program.

Department Action: Partial corrective action taken.

Caltrans applied for additional resources through the budget process to hire a full-time employee to develop formal training for the permits branch staff. This request was unsuccessful, but Caltrans will apply for the funding again in the next budget cycle. Caltrans will continue to use a former permit writer to train staff on a continuous basis until a permanent trainer position has been secured.

Finding #8: Caltrans uses a job classification for permit writers that is no longer appropriate.

One internal factor that might be contributing to high turnover may be a job classification that is no longer appropriate. Permit writers are classified as transportation engineering technicians, a category that requires certain technical skills and knowledge of transportation engineering principles that do not appear necessary for permit writers.

Department Action: Partial corrective action taken.

Caltrans reports that it completed an analysis of skill requirements for permit writers and within the next two years plans to develop options to create or modify existing civil service classifications that best fit the necessary skills for permit writers. Completion of this process depends on the skills and knowledge necessary to operate the new system.

UNIVERSITY OF CALIFORNIA

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

Audit Highlights . . .

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

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

REPORT NUMBER 2000-131, MAY 2001

The Joint Legislative Audit Committee requested that we review the University of California's (UC) practices for hiring assistant, associate, and full professors (professors) to determine whether those practices adversely affect employment opportunities for women. A decline in the proportion of newly hired female professors prompted concern about employment opportunities for women, especially in light of UC's expectation that it will need to hire about 7,000 new faculty members over the next 10 years. Specifically, we found:

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

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

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

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

UC Action: Partial corrective action taken.

UC states that it incorporated these recommendations into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty*. It also states that individual campuses have implemented our recommendation in a variety of ways. For example, the Davis campus developed a target for each school to recruit 80 percent of all new positions at the assistant or early associate professor level. Data for the first year reflect a 70 percent success rate. Also, the Santa Barbara campus will allocate upwards of 70 percent of new faculty positions at the assistant level and will ask deans to evaluate departments' efforts to consider gender equity in the formulation of staffing plans. Further, effective this year, departments on the Irvine campus will conduct an analytical assessment of their diversity profile and will be asked to justify how any new positions will fit their plan.

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

Within the disciplines we reviewed, the search committees for half of the 242 professors hired in fiscal years 1995–96 through 1999–2000 had, on average, either four or five men. The average size of a search committee was six members. Further, the search committees for 156 new professors—nearly two-thirds of those hired—included either no women or only one woman. Finally, while the searches for 83 new professors had no women on the committees, only nine committees did not have any men. Campus representatives told us that female professors can provide search committees with different perspectives that otherwise might be lacking when evaluating candidates.

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

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

UC Action: Partial corrective action taken.

UC states that it incorporated these recommendations into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty* and that they have been widely implemented by each campus. At the Riverside campus, for example, several procedures are in place to ensure that the composition of search committees reflects a diverse cross section of the faculty. Search committees are comprised now of junior and senior faculty members and, in some cases, students. Committees are also required to have at least one member from another department. Further, all search committees have at least one member designated to be the affirmative action/diversity monitor. The composition of the search committee is reviewed and requires approval from the dean, the campus affirmative action officer, and the executive vice chancellor.

However, UC did not provide an action plan that specifically addressed our recommendation concerning the identification of alternatives to its current search committee methods.

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

Search committees on some campuses prepare a document called a search plan before beginning a search. This document details the steps the committee will take, including the job

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

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

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

UC states that it incorporated this recommendation into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty* and that most campuses already adhere to many of the practices in the guidelines. UC also states that the campuses have strengthened existing practices and added new ones to promote diversity and gender equity in faculty hiring. However, UC did not provide an action plan that specifically addressed this recommendation.

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

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

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

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

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

UC states that it incorporated this recommendation into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty* and that most campuses already adhere to many of the practices in the guidelines. UC also states that the campuses have strengthened existing practices and added new ones to promote diversity and gender equity in faculty hiring. However, UC did not provide an action plan that specifically addressed this recommendation.

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

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

To help assess the success of the outreach efforts by search committees in recruiting female applicants and in monitoring the inclusiveness of the hiring process, we recommended that UC compare the proportion of women in the total applicant pool to the proportion in the labor pool as soon as possible after

departments have received applications. If the proportions are not comparable, UC should consider performing additional outreach to identify a broader applicant pool.

UC Action: Partial corrective action taken.

UC states that it incorporated this recommendation into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty* and that most campuses already adhere to many of the practices in the guidelines. UC also states that the campuses have strengthened existing practices and added new ones to promote diversity and gender equity in faculty hiring. For instance, the Irvine campus implemented a new web-based system for gathering and analyzing applicant data on race and gender, which will allow it to provide departments with timely and accurate information for evaluating searches in progress. If the system is successful, it will be a model for the other campuses to follow to improve their current systems of applicant pool tracking and evaluation.

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

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

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

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

UC states that it incorporated this recommendation into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty* and that most campuses already adhere to many of the practices in the guidelines. UC also states that the campuses have strengthened existing practices and added new ones to promote diversity and gender equity in faculty hiring. However, UC did not provide an action plan that specifically addressed this recommendation.

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

Some departments rely on only one member of a search committee when reviewing applications to determine which candidates should be considered further. Such a practice increases the risk that the reviewer's own background, experiences, and biases may unfairly exclude an otherwise qualified individual, regardless of gender. Having at least two members review applications would better ensure that all candidates are fairly considered.

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

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

UC states that it incorporated this recommendation into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty* and that most campuses already adhere to many of the practices in the guidelines. UC also states that the campuses have strengthened existing practices and added new ones to promote diversity and gender equity in faculty hiring. However, UC did not provide an action plan that specifically addressed this recommendation.

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

We found that some departments do not prepare documents summarizing the reasons why candidates did not advance in selection processes. Typically, these deselection documents list the gender and ethnicity of an applicant and the reason why the applicant did not advance further in the hiring process; they are an added control to maintain the integrity of the hiring process.

Without deselection documents, campuses are less sure that otherwise qualified candidates were not unfairly excluded from the selection process.

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

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

UC states that it incorporated this recommendation into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty* and that most campuses already adhere to many of the practices in the guidelines. UC also states that the campuses have strengthened existing practices and added new ones to promote diversity and gender equity in faculty hiring. However, UC did not provide an action plan that specifically addressed this recommendation.

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

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

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

UC Action: Partial corrective action.

UC states that a working group convened by its Office of the President prepared a draft uniform method for all campuses to calculate benchmark data that can be incorporated into existing campus affirmative action plans developed pursuant to federal requirements. The group also developed draft guidelines that are being distributed for review to each campus before formal adoption. Each campus will be responsible for incorporating this benchmark data into its affirmative action plan. UC's Office of the President will centrally collect the campuses' analyses of hiring and benchmark data and monitor campus plans for taking action to address any problem areas.

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

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

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

UC Action: Partial corrective action taken.

UC states that it incorporated these recommendations into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty* and that most campuses already adhere to many of the practices in the guidelines. UC also states that the campuses have strengthened existing practices and added new ones to promote diversity and gender equity in faculty hiring. Further, UC states that most campuses evaluate diversity and gender parity efforts annually. For example, the Santa Cruz campus evaluates all deans and senior academic administrators annually. Its review includes an evaluation of their diversity and affirmative action progress and plans. Further, the Riverside campus is developing a survey to assess the efforts of deans and department chairs to increase diversity and gender equity among faculty. The results of the survey will be compiled in an annual report to all departments so that strategies for success may be shared.

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

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

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

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

UC states that campuses have been active in responding to this recommendation. For example, the San Diego campus has initiated a research, teaching, and service program to foster new areas of research, create opportunities for cluster hiring, and other initiatives that will contribute to the diversity of the faculty.

However, UC did not provide an action plan that specifically addressed our recommendation concerning working with university rating organizations to include gender parity in their definitions of excellence.

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

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

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

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

UC Action: Partial corrective action taken.

UC states that its Office of the President will perform summary level salary reviews annually and work with campuses to resolve any apparent disparities based on race, ethnicity, or gender. Reports of the systemwide salary review will be available to the campuses in Spring 2002. Additionally, UC states that most campuses already have implemented procedures for campus-level salary equity reviews.

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

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

➲ ***UC Action: Unknown.***

UC did not provide an action plan that specifically addressed this recommendation.

UNIVERSITY OF CALIFORNIA

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

Audit Highlights . . .

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

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

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

REPORT NUMBER 2000-130, APRIL 2001

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

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

As of October 1999 casual employees represented 9 percent of the university's employees, despite some general university policies that may have restricted its use of casual employees. The extent to which each campus used casual employees ranged from a high of 24 percent (University of California, Los Angeles) to a low of 10 percent (University of California, Davis) of casual employees to total casual and career employees. Several factors contributed to the differences among campuses in the use of casual employees. For example, the campus that had the lowest proportion of casual employees monitored casual employment centrally to a much greater degree than occurred at most other campuses. Another important factor affecting the number of casual employees was the use of outside contractors at some campuses to perform work that casual employees performed at other campuses. As a result, the number of casual employees on the campuses without these contractors may have appeared disproportionately high.

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

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

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

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

Certain casual employees received benefits that they were not entitled to receive and that others in their position did not because some campus administrators misunderstood university policy. Furthermore, the Payroll/Personnel System required separate codes to identify the employment type—casual or career—and to identify the package of benefits the employee was eligible to receive. However, the campuses' personnel system did not appear to provide an automated check that compared the two codes and disallowed

or flagged an entry that violated university policy. When the university is inconsistent in its treatment of employees, it exposes itself to potential morale problems and questions of fairness. In addition, when campuses provide benefits to casual employees that they are not entitled to receive, they also unnecessarily spend public funds.

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

University Action: Partial corrective action taken.

The university reports that it has clarified its policies by providing training sessions for campus administrators and establishing an administrative web site to help campus administrators understand and implement the new policies. Additionally, articles describing the new policies have appeared in recent issues of the university's human resources publication, which is widely distributed to university staff and academic employees. Finally, the university also states that it has reviewed and modified the Payroll/Personnel System and the Corporate Personnel System to comply with the new rules and to allow the Office of the President to monitor campus compliance with changes in temporary employment policies. The university plans to test the accuracy and completeness of prototype reports from these systems, which the university intends to use to identify any trends that have to be brought to the attention of individual campuses.

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

REPORT NUMBER 2000-132, MARCH 2001

Audit Highlights . . .

Our review of the California Department of Veterans Affairs (department) life and disability insurance program (insurance program) revealed that:

- ☑ *Changes made in the insurance program to reduce its financial liabilities also reduced the program's benefits to veterans.*
- ☑ *It is currently seeking to increase the insurance program's benefits, but the long-term costs and funding for increased benefits are uncertain.*

In the short-term, it could fund increased benefits for veterans by using a limited amount of loan program funds and a modest increase in the premium rates it charges to veterans.

Improvements in its procedures are necessary to effectively manage the insurance program and safeguard its assets.

In conjunction with its California Veterans Farm and Home Purchase program (loan program), which provides low-cost home loans to veterans living in California, the California Department of Veterans Affairs (department) offers a life and disability insurance program (insurance program) to qualifying veterans. The insurance program is intended to provide adequate protection to veterans so that injury or illness will not stop them from making loan payments and so their surviving spouses can pay off all or some of the mortgage. At the request of the Joint Legislative Audit Committee (audit committee), we conducted an audit of the department's insurance program. The audit committee was specifically concerned about the department's management of the insurance program, including, but not limited to, the use of funds, the amount of premiums paid and coverage received by veterans, and future options for the program. The audit committee also requested that we review a study released in February 2001 by a certified public accountant on the department's use of mortgage bond proceeds from 1980 to 1996. Based on our review, we found the following:

Finding #1: In June 1996 the department made sweeping changes to its insurance program, aiming to reduce the program's exposure to substantial estimated liabilities and restore financial stability. As of June 30, 2000, the department had not adequately identified and funded its remaining liabilities.

The department reduced its future liabilities by transferring the majority of its insurance risk to a commercial insurer. However, the department continues to administer a relatively small self-funded plan for those veterans who were receiving disability benefits prior to the June 1996 change. As of June 30, 2000, the department's estimates of liabilities for the self-funded plan totaled

$35 million, however, it has set aside only $22 million in cash to pay for these liabilities. The department does not procure an annual actuarial study of its liabilities for the self-funded plan, instead it estimates its liability each year by adjusting a 1997 actuarial report using the number of loans and projected averages of outstanding loan balances for disabled veterans. The department acknowledges that its current method of estimating liabilities for the self-funded plan needs improvement. However, it believes it can reliably determine its liabilities without an actuarial study because the group of veterans in the plan is small and most are permanently disabled.

We recommended that the department ensure it is able to meet future liabilities for the current self-funded plan by revising its method for annually determining its liabilities and developing a long-term strategy to set aside sufficient cash.

Department Action: Partial corrective action taken.

The department reports that its future liabilities for its self-funded plan are diminishing and it is taking action to ensure it has sufficient funds to meet those future liabilities. The number of borrowers under the self-funded plan is declining as a result of normal loan payoffs. In addition, the department is actively seeking to pay off the loans of permanently-disabled contract purchasers who will accept payoff of their loan balances in lieu of ongoing monthly benefits, thereby, reducing the department's future liabilities.

After it completes all possible loan payoffs, the department reports it will review the economic feasibility of administering in-house all or some of the remaining permanently disabled contract purchasers in the self-funded plan. Further, the department is developing a methodology to calculate the amount of cash needed to fund the program annually.

Finding #2: The department is exploring ways to improve its insurance program; however, unpredictable future costs and the changing demographics of California's veteran population may prove obstacles for the department when selecting options.

The department plans to seek competitive bids from commercial insurers to obtain a wide range of options and associated costs. However, this would provide only a short-term solution because

any proposals the department receives will most likely be based on short-term agreements and will bring higher insurance costs to the program.

In addition, funding options for the insurance program depend on younger veterans qualifying for loans. However, an aging population of veterans in the loan program and a dwindling supply of money for home loans to younger veterans will drive up the costs of providing life and disability insurance to veterans in the loan program.

Finally, in choosing among alternative plans, the department faces a wide range of costs. These alternatives range from returning to a self-funded plan to terminating the insurance program. We estimate 30-year up front costs for these options range from almost $270 million to no cost to the department, but most cost estimates do not include the $35 million liability for those veterans who were receiving disability benefits before June 1996, now covered under the current self-funded plan.

We recommended that when choosing its option for the future of the insurance program, the department establish a long-term strategy for the program that does not adversely affect the financial health or marketability of the home loan program. Any long-term strategy that it develops should include consideration of the following:

- The aging population of the veterans in the loan program.
- The uncertainty of future funding for loans to younger veterans.
- The future costs of the insurance program beyond the five years any group insurance policy will cover.
- The discontinuance of the insurance program for veterans who entered the program after 1996.

In addition, the department should allow public comment and give interested parties an opportunity to present ideas for improving the insurance program and consider the public comments when identifying viable options for the program in order to best serve veterans.

Department Action: Partial corrective action taken.

In order to help ensure future funding availability, the department will continue to work with the other four states with veterans' mortgage programs to loosen federal restrictions on the proceeds of bonds used to finance veterans' home purchases. Current federal restrictions limit the amount of funds the department can loan to younger veterans, thereby, driving up the average age of, and the cost to insure, the current pool of veterans in the insurance program.

In addition, the department is working to solicit bids from insurers on a variety of options for the current life and disability benefits. By examining all the costs associated with insuring and administering the life and disability program, the department reports it will be able to make an informed decision regarding the long-term viability of the loan programs and its ancillary benefit program.

Finding #3: The department has limited choices for funding the insurance program.

The department estimates it can transfer approximately $1.5 million each year in unrestricted funds from the loan program to the insurance program for up to 10 years. However, using the loan program's unrestricted funds for the insurance program will decrease the number of veterans who can receive home loans by about eight loans using current average loan amounts.

On the other hand, modest increases in insurance premiums can provide additional funding for the insurance program. A 10 percent increase in premiums to veterans raises the average monthly premium by $4.23 but generates almost $900,000 annually for the program. A 20 percent increase in premiums for the average veteran in the program raises the monthly premium by $8.65, but generates almost $1.8 million annually for the program.

Additionally, savings the loan program will achieve when the department implements its new administrative cost allocation system in June 2001, could be used to fund increases in the insurance program's benefits. (Its current system has been inappropriately charging the loan program for the costs of administering the department's other programs.) These savings could be as much as $1.3 million annually.

We recommended that when identifying potential sources of funds for improved insurance benefits to veterans, the department should consider modest and appropriate premium rate increases and continue to explore its options for transferring unrestricted funds to the insurance program. In addition, the department should finish implementing its new cost allocation system to ensure it charges only appropriate administrative costs to the loan program, identify the savings to the loan program, and consider using those savings to improve the insurance program.

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

The department did not respond to our recommendation that it look for additional sources to fund the insurance program.

However, in response to our May 25, 2000, report, *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,* the department reports it has developed and tested a process to properly charge direct and indirect costs to its programs, but has not stated whether it intends to use the cost savings to improve the life and disability benefits to veterans.

Finding #4: The department lacks measurable criteria for evaluating its consultant's contract performance.

The department relies on its consultant for expert advice on managing the insurance program, but the consultant's contract lacks enough detail about the extent of services he must provide and specifics about the form he must use to present his results to allow the department to effectively monitor the contractor's performance. Without clearly defining in the contract what it requires of the consultant, the department limits its ability to monitor the consultant's progress and ensure that his work meets the necessary objectives and time frames for effectively managing the insurance program. Further, the department does not have firm policies and procedures in place for its contract managers to follow. Without firm policies and procedures, the department has limited assurance that it complies with state guidelines for monitoring consultant contracts.

We recommended that the department ensure that its contracts reflect the level of service it requires from the contractors by following guidelines set forth in the State Contracting Manual and implement procedures for monitoring the contractor's performance.

Department Action: Partial corrective action taken.

The department reports it is working with its insurance consultant to ensure quarterly and annual reports are completed in a timely manner. In addition, the department's Contract Management Section has completed training contract managers. Training is intended to provide contract managers with a greater ability to develop and write clear, concise, detailed descriptions of the work that will be performed by the contractors, and provide knowledge of techniques to monitor contractual compliance and work performance.

Finding #5: The department lacks adequate controls over cash transactions.

The State Administrative Manual identifies certain duties that should not be performed by the same person because doing so creates an opportunity for theft. Nonetheless, the department allows one person in its insurance unit to perform some of these 'incompatible' tasks. In addition, because of staff vacancies, another person in the accounting unit sometimes performs incompatible duties.

We recommended that the department should protect its assets by ensuring that it establishes and maintains an adequate system of internal controls as set forth in the State Administrative Manual.

Department Action: Corrective action taken.

The department reports that it has reviewed its internal controls and corrected the deficiencies in the separation of duties in the cashiering function. In addition, the department created a detailed matrix of accounting and cashiering duties for routine monitoring of internal control requirements in the event of staff absences, vacancies, or reassignment workload.

DEPARTMENT OF VETERANS AFFAIRS

Weak Management and Poor Internal Controls Have Prevented the Department From Establishing an Effective Cash Collection System

Audit Highlights . . .

Our review of the Department of Veterans Affairs' (department) cash management for itself and its three homes for veterans revealed that:

- ☑ *Since the Department of Health Services decertified the department's Barstow home, the department estimates that this home lost $5.7 million in federal and state funds through June 2001.*
- ☑ *Despite its cash flow difficulties, the department has not taken full advantage of all cash sources available to it, and has been slow to bill a substantial number of Medicare claims.*
- ☑ *The department lacks an understanding of the data in its system, in addition to adequate tools and resources, to allow it to effectively manage the fiscal operations of its veterans homes.*
- ☑ *The department's August 2001 report of its cash flow needs for fiscal year 2001–02 does not meet the requirements in the Legislature's request, and its December report may also be insufficient.*

REPORT NUMBER 2001-113, DECEMBER 2001

The Joint Legislative Audit Committee asked us to examine the Department of Veterans Affairs' (department) management of cash flow for its veterans homes and the central headquarters operations supporting these homes. We found the department has poorly managed its cash and that of its three veterans homes, and it has failed to pursue some reimbursements to which it is entitled. In addition, we noted that the department lacks the tools to manage and control effectively the fiscal operations of its veterans homes, and that its attempts to alleviate its cash flow problems have not been successful. Finally, the department's August 2001 report on its cash flow needs did not meet the requirements in the Legislature's request. Specifically, we found:

Finding #1: The department does not bill for all the services that its homes provide.

The department faced significant cash shortages because one of its veterans homes has suffered from substandard level of care and because it has not been billing for all of the services that its homes supply to veterans. Specific areas our audit identified include:

- The Department of Health Services (Health Services) withdrew the certification for the Veterans Home of California, Barstow (Barstow home) in July 2000 because of the home's substandard level of care of residents. This decertification prevented the Barstow home from qualifying for federal payments for its daily care of residents and for Medicare and Medi-Cal reimbursements. Consequently, the department estimates that it lost $5.7 million in federal and state funds from June 13, 2000, through June 2001. To compensate for the loss of these reimbursements, the Legislature authorized additional appropriations totaling $5.5 million from the State's General Fund.

- The department has not tried to collect the total amount of secondary insurance charges for which it could bill. The department has a policy that directs staff to not spend time billing secondary insurers directly or following up on claims billed automatically by Medicare. Our review indicated that the department's investment of time to perform these additional billings would be negligible, although we did not find that the department would recover large amounts of money from these secondary insurers. Nevertheless, this additional billing does represent a source of reimbursements that the department has not adequately explored.

- Billing errors and lack of adequate documentation may be costing the department additional reimbursements. Of a 100-chart sample of patient charts and their corresponding bills, department consultants noted that 50 charts had no corresponding bills. In the remaining 50 charts for which they could find bills, the consultants noted 158 errors, including 73 cases where the department had not billed or had underbilled for some services and 85 instances in which the department may have billed services erroneously. Neither we nor the department can say with certainty the amount of reimbursements that it may have lost, but given the error rate in the consultant's sample, this number may be significant.

- Staffing issues have contributed to the department's billing problems. Headquarters staff stated that a major contributor to the department's delays in filing claims was the shortage of utilization review nurses and health records technicians. During the period of November 2000 to May 2001, the Veterans Home of California, Yountville (Yountville home) had staff for only one of two budgeted positions for utilization review nurses, and four of six approved positions for health records technicians. The department estimates that these staffing shortages caused the Yountville home to lose $217,000 in possible reimbursements for skilled nursing care from July 2000 through July 2001. Although the home unsuccessfully tried to hire utilization review nurses on a temporary basis, it did not consider other ways to alleviate its staffing shortage. We also noted that salaries for these positions are lower than the average market wages for similar classifications in state and local government in the San Francisco area where the Yountville home is located.

- The department may have lost additional funds by failing to follow through on recommendations from auditors and consultants. As of October 24, 2001, the department has resolved only

15 of 40 outstanding issues brought to its attention by its billing consultant in calendar year 2000 and again in January 2001. The consultant had noted that the open issues were affecting the department's ability to collect reimbursements for the services provided by the homes.

To ensure that it is billing for all services provided by its three homes for veterans, we recommended the department do the following:

- Continue to seek recertification for its Barstow home so that this home can bill for Medicare and Medi-Cal reimbursements.

- Notify Health Services when the department believes that the Barstow home is ready to undergo a new survey that will lead to recertification.

- Follow up on claims submitted to secondary insurance providers to ensure that it has received reimbursements and that staff reworks rejected or denied claims promptly. In addition, to recover additional reimbursements, the department should submit claims to secondary insurance providers that it has not usually billed.

- Correct the information system and process deficiencies noted by its consulting group in the 100-chart sample. If time limits have not expired, the department should also resubmit claims for the items that it underbilled.

- Consider options to fill utilization review nurse shortages, such as transferring qualified staff to the utilization review section and hiring from nursing registries to replace these staff until the Yountville home can hire and train permanent utilization review nurses and health records technicians.

- Investigate the salary levels and classifications for trained utilization review nurses and health records technicians to determine whether it needs to work with the State Personnel Board to change salary levels for these positions.

- Assign to a department staff member the responsibility for implementing consultant and auditor recommendations. This employee should have sufficient authority to ensure that units in the department complete recommended tasks.

Department Action: Partial corrective action taken.

The department's initial response indicated that it had taken the following actions:

- Notified Health Services on October 25, 2001, that the Barstow home was ready to undergo a new survey. An initial survey was performed on November 2, 2001.

- Made the business decision to allocate its staffing resources toward collecting high dollar collections, which does not include secondary insurance collections, in order to optimize cash for the department.

- Implemented procedures to correct some of the deficiencies noted in the consultant's sample, is planning to address the other issues of chart documentation and correct entry of charges, and will review the accounts identified in the sample to determine if sufficient data is now available to resubmit valid and compliant claims.

- Hired two qualified utilization review nurses and is using a temporary help agency for other key billing positions until it can hire permanent employees. Additionally, the department's personnel services division will perform a job classification audit, and present its findings to the Department of Personnel Administration for recommended action.

- Strengthened its organization with the addition of a deputy secretary over all veterans homes and the development of a revenue council specifically committed to ensuring the proper collection of all reimbursements. Additionally, it has hired an individual to act as a collections manager who is assigned to the deputy secretary of the homes and the chief of financial services.

Finding #2: The department does not bill promptly for its services.

The department has further compounded its cash flow difficulties by failing to submit promptly its claims for certain reimbursements. The department failed to bill Medicare for outpatient services provided by one of its homes between August 2000 and June 2001 until June 2001 because, in part, its employees did not understand how policy changes made by the federal government would affect the department's billing procedures. However, we did not find this

10-month delay to be reasonable because the department had sufficient notice of the federal government's planned policy revisions to begin making changes to its billing system. Our testing of a sample of 44 claims generated during fiscal year 2000–01 revealed that the department averaged 207 days from the last date of service to the date that it submitted the claims to Medicare for the 25 claims that it billed. For these 25 claims, Medicare averaged 27 days from the date the department submitted the bills to the date that the federal agency either paid or rejected them.

We recommended that the department continue to focus on clearing its backlog of claims and ensuring that staff perform all tasks related to billing to ensure that it is billing claims promptly.

Department Action: Partial corrective action taken.

The department states that its utilization review is current for July through September 2001 and that it has billed all approved stays with accounts finalized by its medical administrative services unit. In addition, its reimbursement staff will be immediately billing all backlogged claims once they receive an appropriate utilization review notice from the homes and staff at the homes have finalized all coding.

Finding #3: Insufficient information hampers the department's management of reimbursements.

The department lacks sufficient knowledge of the data in its billing management information system (information system), which has caused the department to overestimate the total reimbursements that it believes it can recover. In July 2001 the department retained a consultant to assist in billing outstanding charges, estimating that the consultant could recover up to $6 million. However, as of September 30, 2001, the department's consultant has been able to recover only between $350,000 and $450,000. Erroneous accounts in its system prevent the department from accurately determining how many accounts remain that it can bill. For example, as of August 31, 2001, the Yountville home had 3,076 outpatient clinical accounts with no charges from fiscal year 2000–01. Our testing of 309 of these accounts revealed that 22 accounts had actual charges totaling almost $4,800 that should have been entered and processed for billing. We also found charge slips for 19 accounts for which the home provided services but that were not billable to an insurance provider. We could not find charge slips for the remaining 268 accounts.

To ensure that it has a sufficient understanding of the accounts and data in its information system, the department should do the following:

- Analyze costs and benefits of continuing to hire consultants to bill for prior-year charges to determine whether reimbursements will adequately cover costs for hiring consultants. Further, if the department decides to keep its current information system, it should hire a consultant knowledgeable in the department's current information system to assist the department in cleaning up erroneous data, applying credits to accounts for which payments have been received, and processing all unbilled charges in the system, in addition to assisting the department in developing written business policies and practices and training staff.

- Finish implementing a system of numbered charge slips to ensure that all staff at its veterans homes have entered all data.

- Investigate accounts with no charges to determine whether the department can submit claims or should delete these accounts.

Department Action: Partial corrective action taken.

The department will perform a cost-benefit analysis of recent consultant contracts to serve as a baseline for future contracting decision. In addition, it will also document its cost-benefit analysis prior to executing future consultant contracts for collection of prior-year reimbursements. The department indicated that it is still evaluating whether to use its current information system or to purchase a new system. In the meantime, it is dedicating significant travel and training funds to ensure information systems staff receive training on upgrades to its current system. Additionally, it pledged to continue efforts to fund business process reengineering to address the development of written business policies and practices as well as providing additional training for system users. Moreover, the department will continue implementing a system of numbered charge slips and assure implementation at all three homes. The department also stated that it is purging all accounts prior to October 1, 1999, as these accounts are no longer collectible due to Medicare claim submission time limits. In addition, it has produced reports to determine if any zero charge accounts are duplicate or incorrectly set up accounts, and will be deleting these accounts as non-collectible erroneous accounts.

Finding #4: The department does not prepare management reports or fully access its information system.

The department cannot accurately estimate the amount of unbilled charges in its information system because the system includes erroneous amounts. Without sufficient knowledge of the amounts available to it for billing, the department cannot effectively monitor and manage its billing and collection process, nor can it prepare useful management reports. Our review of cash position reports prepared by the department's reimbursements unit from data in the department's information system noted significant differences between totals in this report and totals in the department's accounting system. Because the department's accounting system cannot track unbilled charges, the department may be missing opportunities to collect reimbursements because it cannot evaluate its effectiveness in billing claims using data from that system. Further, the department's information system has tools and reports that can assist management in controlling cash flow; however, management at the department and at the veterans homes appears not to be using many of these. Although the veterans homes use only 41 of 76 modules purchased by the department for their use, the department estimates it will pay $81,000 to $251,000 per home to maintain all the modules in fiscal year 2001–02.

We recommended that the department develop periodic management reports, and regularly reconcile these reports with the department's accounting records in order to evaluate the cash flow at headquarters and at all three homes with respect to reimbursements, expenditures, accounts receivable, and unbilled claims.

Department Action: Partial corrective action taken.

The department has developed a series of reports including cash collections per week by source of revenue, cash flow analysis for each home, and monthly expenditure analysis for each home. The department agrees that it should develop additional reports that more discretely predict accounts receivables, and is in the process of developing lag reports and segregating billable charges from unbillable charge data in the information system.

Finding #5: The department's internal controls lack adequate oversight.

The department's oversight of internal controls has serious shortcomings. Despite its awareness that its internal controls, including its business policies and practices, exhibit consistent deficiencies, the

department has not made sufficient effort to correct known problems. In addition, the department has not had an external audit or internal review of its internal controls since 1994. According to our limited review of the department's operations, the department exhibits to some degree most of the warning signs that appear on the State Administrative Manual's list characterizing poor maintenance of an internal control system. For example, the department did not keep current its policies and procedures manuals, and it does not produce accurate operational reports it could use as management tools.

In addition, although the Legislature transferred the responsibility for internal audits to the Inspector General for Veterans Affairs (inspector general), it did not give the inspector general access to all departmental records. Without access to many confidential records, the inspector general is unable to review many of the department's controls.

We recommended that the department ensure that regularly scheduled reviews of its internal controls are performed to provide assurance that the department's mission is carried out and that the department is maintaining effective control over assets, liabilities, reimbursements, and expenditures.

In addition, if the Legislature believes that the intent of its legislation creating the position of inspector general is not being met, it should consider clarifying state law governing the inspector general so that the inspector general has appropriate access to all department records.

Department Action: Pending.

The department pledged to conduct regularly scheduled reviews separately and in conjunction with the inspector general. Furthermore, the results and recommendations of prior reviews will be submitted to the Executive Council of the Veterans Homes or the Secretary's Office, as appropriate, for implementation in the next six-month period.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Finding #6: The department has demonstrated an inconsistent approach to fiscal management.

In August 2001 the department proposed a reorganization for the oversight of its homes. Nevertheless, the department has used an inconsistent approach to fiscal management. The department recently returned some tasks to the homes with the goal of enabling each veterans home to better manage its budget, however, it did not ensure that the homes had access to current, accurate data or to a functional information system. Additionally, the department did not give the homes adequate written guidance or performance measures, nor did it enter budget data into its accounting system or list budget targets for the veterans homes until October 2001, three months after the start of the fiscal year.

We recommended that the department continue to define and clarify in writing the division of responsibilities between headquarters and the veterans homes to make certain that expenditure and reimbursement activities have appropriate oversight.

Department Action: Partial corrective action taken.

The department's veterans homes division is currently making organizational and management changes at all homes. In addition, the department has appointed a revenue council to review the entire revenue and reimbursement process and provide a date when the department can begin implementing revisions to the system. The revenue council will develop process standards with monitors and a balanced scorecard, and will report monthly to the veterans homes executive board, who in turn will report to the governing board. Management at each level will review the report and balanced scorecard and intervene when necessary. The department will document the process in the Veterans Homes Division Administrative Manual.

Finding #7: Lack of appropriate training continues to hamper claims processing.

In general, the department may not have optimized its use of its training dollars for its billing staff. In fiscal year 2000–01, the department spent at least $66,040 for training, of which only $1,000 went to training for medical billing. This training was general in nature and did not significantly increase staff's knowledge of billing procedures. An additional $935 of the $66,040 training funds went to lost registration costs due to last-minute cancellations by

department staff. Moreover, of the 68 training classes offered to Barstow home staff, and 118 hours of training provided to Yountville home medical billing staff, none applied to medical billing. Recent changes in Medicare filing requirements make training critical for the department. Partly because of its staff's lack of billing expertise and knowledge, the department hired a consultant in July 2001 to assist it in processing backlogged claims for October 1, 1999, through June 30, 2001. The contract will cost up to $400,000, and the department has budgeted $810,000 for another consultant to assist it in processing claims for fiscal year 2001–02.

The department should provide training opportunities for department staff, particularly staff involved in processing claims, to ensure that they stay informed about current developments in Medicare regulations and policies.

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

The department has assigned a reimbursements staff member to review all Medicare bulletins and advise staff of all regulation and policy changes that affect reimbursement activities. The reimbursements unit will be participating in training classes offered by a variety of sources.

Finding #8: Poor management has caused deficiencies in the department's information system.

The department has not provided adequate leadership to ensure that the veterans homes have a usable information system. Poor management, lack of executive sponsorship, and insufficient training have all contributed to deficiencies and errors in the data recorded in the department's information system. The department has not made certain that staff and management accept the system, nor has it provided sufficient resources, including adequate training, to implement the information system successfully. Finally, the department has failed to fulfill its own as well as its consultants' recommendations for resolving information system issues. These weaknesses have resulted in an information system that does not assist the homes in tracking services provided to patients and in collecting reimbursements for services provided.

The department should decide how it will satisfy its three veterans homes' conflicting needs for an information system, and implement a decision fully supported by management. If it retains its current information system, the department should ensure that it

fully develops and completes the data dictionaries and that staff receives adequate training to maintain and operate the information system. We also recommended that the department perform business process reengineering, including developing written business policies and practices that require staff to carry out necessary tasks and to receive adequate training. If it deems it cost-beneficial, the department should consider hiring a consultant to assist it in these tasks and to help the department develop its business solution.

Department Action: Partial corrective action taken.

The department states that its information technology council has developed a two-pronged strategy. The first objective is to implement an upgrade to the information system in order to satisfy federal requirements. The second objective is to determine what system would better meet the needs of the veterans homes both short- and long-term. The council will report monthly to the homes' executive board who in turn will report to the governing board. Management at each level will review the report and balanced scorecard and intervene when necessary. The department intends to document the process in the Veterans Home Division Administrative Manual.

Finding #9: Limiting expenditures was not as effective as the department had anticipated.

The department has attempted to control its cash flow by limiting expenditures at the homes and at headquarters. However, this has not solved the department's problems with cash management. In fact, the department has actually increased its expenditures since implementing cost-cutting measures in January 2001. The department increased its use of consultants because it has had difficulties obtaining reimbursements from insurers and it signed contracts totaling $4.7 million for consultant services begun or continued in fiscal year 2000–01. Because the department has decreased its collections of reimbursements from insurers and has been unsuccessful in decreasing expenditures, the State has supplied additional funding for the department. However, this draws on state funds that could be available for other uses.

To better ensure that it meets its cash flow needs, the department should examine its use of consultants to consider how best to allocate resources to obtain needed services. In addition, the department should analyze the costs and benefits of contracting

out its billing and collections functions and eliminating excess positions, to determine whether it can avoid paying both consultants and staff to perform similar functions.

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

The department believes that the consulting services retained by the department to date have not performed any duplicate services or functions that current department staff perform.

Finding #10: The August report on cash flow does not supply the information requested by the Legislature, and the department's December report may also fall short of legislative requirements.

The Legislature directed the department to provide a report as of August 31, 2001, that details the department's needs for cash. However, the department did not fulfill this request adequately. Specifically, the department report omits the department's starting cash position, and it does not show expected reimbursement collections or expenditures by month. Our review also noted that rather than offering a cash flow forecast, the department's report merely repeats material from the department's budget from the 2001–02 Final Budget Summary. Although it is working on a new format for the next report, due in December 2001, it has not yet finalized the methodology to estimate accurately its accounts receivable. Additionally, deficiencies in the August 2001 report will render the next report useless for making comparisons. Therefore, the department and the Legislature will be unable to use these reports to determine the causes and fiscal implications of the differences between the reports.

To support and improve its process for developing analyses of its future cash flow needs, the department should continue to prepare the detailed estimates and supporting schedules that it needs for its December 2001 and February 2002 reports to the Legislature.

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

The department reports that it has begun a series of analyses reviewing prior-year historical data, actual cash collections, and projected expenditures to better articulate the flow of collections and expenditures. The department states that it must collect revenues within 60 days of the date of service in order to make budget projections. Additionally, the department intends to provide the Legislature with schedules depicting potential collections, actual billings, and actual cash collected in comparison to budget. In order to estimate expenditures, the department will forecast all accruals and estimated payrolls based on a combination of budget projections and actual expenditures through the most recent month.

THE COUNTY VETERANS SERVICE OFFICER PROGRAM

The Program Benefits Veterans and Their Dependents, but Measurements of Effectiveness as Well as Administrative Oversight Need Improvement

REPORT NUMBER 99133, APRIL 2000

Audit Highlights . . .

Our audit of California's County Veterans Service Officer program (CVSO program) revealed:

- ☑ *The CVSO program has played a key role in helping veterans, but reports of significant benefits and savings cited as program accomplishments should be viewed with caution.*
- ☑ *Other indicators should also be used by county CVSO programs and the California Department of Veterans Affairs (department) to gauge the effectiveness of the program.*
- ☑ *The department does not ensure that its allocations of state and federal funds to counties are based on accurate data.*
- ☑ *Furthermore, the department needs to improve its oversight of the training and accreditation process for CVSO personnel.*

At the request of the Joint Legislative Audit Committee, we audited the County Veterans Service Officer program (CVSO program). As part of this audit, we reviewed operations at the California Department of Veterans Affairs (department) as well as three counties that participate in the CVSO program (CVSOs). This report concludes that although the CVSO program benefits veterans, methods for measuring its effectiveness need improvement and the department should improve the administrative oversight of the program.

Finding #1: The department's reporting of certain benefits and savings is inaccurate.

The department reports new and increased benefits to veterans as accomplishments of the CVSO program. However, some CVSOs that we visited erroneously reported the full amount of the new compensation they obtained for veterans. The CVSOs should have reported the incremental increase in those instances in which veterans received increases in the monthly compensation they were awarded previously. Also, when it estimates local tax revenues that occur because of the program, the department calculates these estimates using outdated and irrelevant data. Further, the amounts that the department reports as public assistance savings resulting from the program are not always actual savings. Finally, the department does not list savings to the Medi-Cal program as accomplishments of the CVSO program even though efforts by the CVSOs to verify veterans' income for the program are much the same as their efforts for the public assistance program. As a result, those who make decisions about the CVSO program should view with caution the department's reports of benefits and savings achieved by the program.

We recommended that the department clarify instructions so that CVSOs report only the increase in a benefit award and develop an appropriate estimating technique for calculating local tax revenues resulting from veterans benefit awards if the department continues reporting these revenues as benefits of the program. Additionally, we recommended that the department ensure it reports accurate savings if it wants to continue reporting public assistance savings to counties and consider whether it should report savings for the Medi-Cal program. If identification of actual savings is too labor-intensive, the department should determine whether it can provide counties with a reasonable estimate of the savings.

Department Action: Partial corrective action taken.

The department stated that it changed the wording for the procedure for posting claim awards so that only the increase in a benefit award will be reported to the department. As it relates to developing an appropriate methodology for calculating local tax revenues, the department stated that it had contacted various agencies about this, but no fixed method had been decided upon. In May 2000 the department and the California Association of CVSOs (CACVSO) initiated discussions as to whether to continue reporting public assistance savings. The department stated that further discussions with the CACVSO are required on this issue. The department did not address what it was planning to do in reporting savings for the Medi-Cal program.

Finding #2: CVSOs do not ensure the accuracy of the information reported.

The CVSOs we visited lacked effective procedures for ensuring the accuracy of benefits and savings data they submit to the department. Because the department relies on this data when it prepares reports on the program's accomplishments, such reports may contain inaccurate information. Similarly, no CVSO we visited had adequate procedures for verifying the accuracy and completeness of the workload data it submitted to the department. All three CVSOs we visited submitted workload-activity reports that contained errors. Data errors have the potential to prevent CVSOs from obtaining equitable funding for their operations.

To improve the accuracy with which they report program information to the department, all CVSOs should implement appropriate controls over the reporting of benefits, savings, and workload data.

CVSO Action: Partial corrective action taken.

The CVSOs we visited report that they have implemented or plan to implement controls over the reporting of information they submit to the department.

Finding #3: CVSOs should do more to analyze their own operations.

Benefits and savings should not serve as the only measure of whether the CVSOs are serving veterans successfully. Counties should look directly to their CVSOs for evidence of their effectiveness, and CVSOs should supply their counties with key indicators of their performance. Each of the CVSOs we visited do, to varying degrees, furnish program performance data directly to their counties, but more analyses should be done using other effectiveness measures that all CVSOs have readily available. Further, CVSOs should analyze their operations and implement practices to improve their own operations. Establishing meaningful performance measures and periodically analyzing operations are important steps to ensure that the CVSO program is as effective as possible.

We recommended that CVSOs work with the department to develop goals and productivity measures for CVSOs. We also recommended that CVSOs report to their respective counties and the department annually their progress in meeting the goals and productivity measures. Finally, we recommended that the CVSOs analyze their own operations and implement practices to improve their operations.

CVSO Action: Partial corrective action taken.

Previously, the CVSOs we visited reported they were working with the department, through the CACVSO, to develop goals and productivity measures for CVSOs. Two of the CVSOs now state that they agree with the department that each respective county should develop goals and productivity measures. They also stated that they now report their progress to their counties and would provide the department a copy of their progress and accomplishments annually once a statewide reporting system is implemented. One CVSO did not directly address the status of its efforts in developing goals and productivity measures in its one-year response to us. Additionally, the CVSOs report that they have either implemented or plan to implement our recommendation that they analyze the effectiveness of their operations.

Finding #4: The department should establish statewide goals and investigate why county data vary.

The department could do more to enhance the effectiveness of the CVSO program throughout the State. The department does not analyze the data it receives from CVSOs, does not perform comparative analyses, and does not attempt to determine reasons for differences in key performance indicators. Without such an analysis, it is difficult for the department to identify areas in which the CVSOs and the entire program can improve. In addition, although the CVSOs we visited state that many veterans who may be entitled to benefits are not aware of their eligibility, none of the CVSOs had established goals or a means to measure the effectiveness of outreach programs. We also noted that the department had not worked with the CVSOs to establish statewide goals and a means to measure progress toward the goals.

We recommended that the department work with CVSOs to develop program goals and productivity measures to report to their county governments, and that it require CVSOs to report annually to the department on their progress in meeting the goals and measures. Moreover, we recommended that the department set statewide goals for the CVSO program, such as goals for reaching out to veterans not yet served, and establish measures to determine their achievement. Finally, we recommended that the department analyze differences among counties using key information reported by CVSOs.

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

In its previous status reports to us, the department indicated that it was working with CVSOs to develop program goals and productivity measures with a target date of April 2001 for completion. However, the department did not address the status of this effort in its April 2001 one-year status report to us. Also, although the department stated that it agreed with our recommendation to set statewide goals, establish measures to determine their achievement, and analyze differences among counties, the department did not specifically address its progress in these areas.

Finding #5: The department needs to improve how it distributes state and federal funds to counties with CVSOs.

The department does not use an appropriate basis for distributing a portion of its subvention funds to CVSOs. The department also contracts annually with the Department of Health Services to

obtain federal funds to reimburse CVSOs for a portion of their costs for performing activities that result in savings to the Medi-Cal program. When the department allocates these funds, it uses figures for workload activities related to the cost-savings program for Medi-Cal. However, when the department allocates its subvention funds, it inappropriately uses some of the Medi-Cal workload activities reported by the CVSOs. Additionally, it does not ensure that its subvention allocation process meets limitations set by state regulations. When the department inappropriately allocates funds, some counties may not secure their fair shares of available funds.

The department should modify its allocation procedures for subvention funds to ensure it uses only appropriate workload activities as the bases for its allocations. The department should also comply with all allocation limitations set by state regulations.

Department Action: Corrective action taken.

The department states that it discontinued using Medi-Cal workload units and would only use appropriate workload data as the basis of allocating subvention funds. The department also believes it is now complying with all subvention-allocation requirements.

Finding #6: The department does not verify the accuracy of data it uses in its decisions for allocating funds.

Although the department bases its allocations of state and federal funds for veterans services on workload data from CVSOs, the department has not followed state regulations and audited CVSOs to ensure that such data are correct. In fact, although audits of selected CVSOs are required annually, the department has performed only one such audit since 1996. As a result, counties may not be receiving equitable funding for veterans benefits and services.

We recommended that the department audit CVSOs, as required by state regulation, to validate the workload activities it relies upon in the allocation process, or seek to change the regulation. If it chooses to change the regulation, the department should either establish an alternative process to ensure data accuracy or justify why an alternative is unnecessary.

➲ ***Department Action: Pending.***

In its one-year status report to us dated April 2001, the department stated that it planned to begin audits of the CVSOs in September 2001. The department did not discuss a schedule for these audits. Thus, it is unclear how many CVSOs are being audited and how often the audits will occur.

Finding #7: The department needs to ensure that CVSOs receive appropriate reimbursements for cost-savings activities.

The department may be missing an opportunity to obtain additional federal funds for CVSOs. Although the department has an agreement with the Department of Health Services to provide federal funding for CVSO activities that reduce Medi-Cal costs, the department does not have an agreement with the Department of Social Services to provide for federal reimbursement of similar CVSO activities that save public assistance dollars. Additionally, the department cannot demonstrate that the methodology used to compute the Medi-Cal funding—a methodology that includes workload estimates developed in fiscal year 1993–94—is still appropriate. As a result, the department cannot be sure it is receiving an appropriate level of reimbursement for the counties' cost-savings activities.

The department should seek to negotiate an agreement with the Department of Social Services that would reimburse counties with federal funds for CVSOs' efforts in reducing public assistance costs. The department should also review the workload estimates developed in fiscal year 1993–94 under its agreement with the Department of Health Services for claiming reimbursements for the Medi-Cal cost-saving activities so that the department confirms that the estimates are still appropriate.

Department Action: Partial corrective action taken.

In its one-year status report to us dated April 2001, the department stated that it expected to contact the Department of Social Services in the summer of 2001 about negotiating an agreement that would reimburse counties for efforts in which the CVSOs have reduced public assistance costs. Related to the methodology for reimbursing the counties for reduced Medi-Cal costs in May 2000, the department initiated discussions with the CACVSO. According to the department, further discussions are required and were also expected to take place in the summer of 2001.

Finding #8: The CVSOs we visited did not use their increased state funding to expand or improve program services.

Although the Legislature provided extra state funds for veterans services, the CVSOs missed an opportunity to use the increased funding to expand or improve program services. During fiscal year 1998–99, the Legislature increased its funding for the CVSO program by more than 30 percent. The Legislature did not state how the CVSOs were to use the augmentation. Thus, the counties had the latitude to use the money as they wished. The counties we visited used the augmentation to partially offset the funds they provided for CVSO operations rather than to expand or improve the services offered to veterans by increasing the total funding spent on the program.

We recommended that if the Legislature makes future budget augmentations, it should clarify whether it intends counties to use the money to decrease their funding of the CVSO program or to supply additional resources for CVSOs so they may expand or improve program services.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Finding #9: The department needs to improve its oversight of the training and certification process for CVSO personnel.

The department, like the federal Department of Veterans Affairs (VA), recognizes that individuals who assist veterans in securing VA benefits must be knowledgeable in their field. It has a generally suitable accreditation process for training and certifying those who seek to represent veterans and their dependents. However, the department lacks procedures for identifying CVSO personnel who require such accreditation. In fact, at each of the three CVSOs we visited, we encountered at least one individual assisting and counseling veterans who had not earned accreditation from the VA. Although these individuals may possess adequate knowledge to represent and assist veterans effectively, their lack of accreditation exposes them to the potential criticism that they are unqualified.

Additionally, the department does not verify that those who have been accredited take required ongoing training. Further, the department has failed to demonstrate that it consistently updates or receives VA approval for its training manuals and examinations.

As a result of these conditions, the department increases the risk that CVSO staff who assist veterans may not have all the knowledge they need to perform their jobs.

CVSOs should ensure that those lacking VA accreditation seek it, and the department should develop procedures to identify CVSO personnel who require accreditation and make sure they take proper steps to become accredited. In addition, the department should create procedures to verify that training materials, including manuals and examinations, receive necessary, regular updates that include information from department bulletins and other sources. In addition, the department should ensure that the VA approves all new instructional materials, including training manuals, updates to manuals, and each certifying examination. Finally, the department should review its training requirements and procedures to ensure that accredited CVSO personnel receive adequate ongoing training.

CVSO Action: Partial corrective action taken.

One CVSO we visited stated that all of its individuals who assist veterans would be accredited within one year of employment. Another CVSO stated that a new hire would be accredited with the department in the near future. A third CVSO we visited stated that its new hires would be tested for accreditation within a few months.

Department Action: Corrective action taken.

The department has developed an accreditation questionnaire that was sent to each CVSO to complete for each staff member who counsels and assists veterans. Completed questionnaires are returned to the department where a list of accredited and nonaccredited representatives is being compiled. All nonaccredited personnel are then contacted concerning training and testing. In addition, the VA approved the latest accreditation test in August 2000. Further, the VA has reviewed and provided comments on the department's revised training manual. Finally, the department stated that it had developed procedures to ensure that all CVSO personnel will receive regular supervision, monitoring, and annual training.

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

REPORT NUMBER 99139, MAY 2000

Audit Highlights . . .

Our review of the California Veterans Farm and Home Purchase Program reveals that:

- ☑ *By the end of the decade, eligibility for one type of loan and the limited funds available for the two remaining types of loans will severely diminish the program's value to most veterans.*
- ☑ *Poor budget controls, improper administrative charges, and inefficient and inconsistent operations have raised program costs and further eroded funds otherwise available for loans.*
- ☑ *Mismanagement of the implementation of a new integrated information system resulted in its failure to meet the needs of the program without an additional investment of time and program funds.*

At the request of the Joint Legislative Audit Committee (audit committee), we conducted a fiscal and program compliance audit of the California Veterans Farm and Home Purchase Program (Cal-Vet program). Specifically, given the aging population of eligible veterans, the audit committee was concerned about the program's future. The committee was also concerned with conclusions by the Legislative Analyst's Office that the Cal-Vet program was not competitive with other loan programs. Based on our review of the Cal-Vet program, we found the following:

Finding #1: A rapid decline in the population of eligible California veterans and limited funding threaten the long-term viability of the Cal-Vet program.

The Cal-Vet program provides loans to thousands of qualified veterans at below-market interest rates. Because federal restrictions severely limit eligibility for the Cal-Vet program's major source of funding for loans, proceeds from tax-exempt Qualified Veterans Mortgage Bonds (QVMBs), demand for these loans will drop dramatically over the next 10 years. The Department of Veterans Affairs (department) has lobbied Congress over the years to modify the restrictions on QVMBs, but it has been unsuccessful. The program has two other sources of funding, Qualified Mortgage Bonds (QMBs) and unrestricted funds, but approval to issue QMBs is difficult to obtain and unrestricted funds are drying up.

The department's lending strategy is to increase the total value of its loan portfolio. For the eight-month period of July 1999 through February 2000, the Cal-Vet program loaned $361 million, $25 million above its goal for the entire fiscal year. During this period, the Cal-Vet program charged 5.95 percent for QMB loans and 6.65 percent for both QVMB and unrestricted loans. Because

the program's interest rates are as much as 2 percent below market interest rates, it is attracting many loan applicants; however, the frequency at which the department is now making loans will substantially exhaust the available QMB and unrestricted funds by 2006, with only residual recycled principal and interest from unrestricted funds available for loans.

We recommended that the department should determine how to use its remaining funding to best serve veterans in purchasing farms and homes. If it decides to continue its present strategy of using available funds to provide loans at the lowest possible rates, it should plan for the future curtailment of new loan activity. If the department determines that veterans are best served with loans having interest rates closer to market rates and expands its pool of funds with alternate financing methods, it should maintain current demographic data to identify veterans eligible for, and likely to participate in, the Cal-Vet program and adapt the program to provide home loans to the greatest number of qualifying veterans for as long as possible.

In the absence of sufficient tax-exempt financing to ensure the continued viability of the Cal-Vet program, we recommended that the Legislature consider using state funds to establish a new program to aid California veterans in purchasing farms and homes.

Department Action: Partial corrective action taken.

The department reports it is taking actions to adapt the Cal-Vet program to provide a home loan benefit to the greatest number of veterans for as long as possible. Using veteran population demographic data collected from the federal Department of Veterans Affairs, the department will identify changes in the veterans population for the next 10 years. In addition, the department has gained approval from the California Veterans Board and the Veterans Finance Committee of 1943 for a rate-setting methodology that will allow the Cal-Vet program to more quickly adjust its interest rates in reaction to fluctuations in market interest rates. Further, the department continues its efforts, along with other states with similar loan programs, to convince Congress to extend the eligibility requirements for QVMBs to veterans of more recent combat actions.

The department reports it will also vigorously pursue additional sources of program funding to benefit as many veterans as possible, and has identified some new sources of funding. However, the department, along with its quantitative consultant, has determined that there is no immediate need to implement new sources of funding at the present time.

Legislative Action: Unknown.

We are unaware of any legislative action to implement our recommendation.

Finding #2: Improperly charged administrative expenses and inefficient loan processing deplete the already limited funds available for loans to veterans.

Additional concerns in the Cal-Vet program are poor budget controls and a lack of consistency and efficiency in program operations. Most significantly, department records indicate as much as $1.3 million of Cal-Vet program funds in a single year were paid for the costs of administrative staff who did not provide service to the program or for staff whose service to the program had not been documented. The department has implemented improvements in the efficiency of its Cal-Vet program operations, such as centralizing loan contract servicing, adopting new loan underwriting standards, instituting mortgage insurance, and improving its management of delinquent and foreclosed loan contracts. However, it has not fully implemented other reengineering changes in the Cal-Vet program that it has identified as necessary to become more efficient in its operations. Because the department has not completed its reengineering efforts, which include the centralization of its loan-processing operations and implementation of workload standards for its field and headquarters offices, the average cost to process loan applications has increased, costs vary significantly by field office, and loan applications take longer to process than is common in the industry.

We recommended that the department ensure its direct and indirect administrative costs are properly and equitably charged to all programs served by administrative staff, that it identify the amount of Cal-Vet funds it has used for activities outside the program, and that it seek reimbursement from other appropriate state funds. In addition, to further increase the efficiency and consistency in the Cal-Vet program's operations, and thereby reduce costs and improve loan-processing times, we recommended that the department complete its reengineering efforts.

Department Action: Partial corrective action taken.

The department reports it has developed and tested a process to allocate direct and indirect budgeted program expenditures to the programs actually incurring the costs. Under the department's new process, direct labor hours are charged directly to the program on which employees work. Indirect labor, employee benefits, space costs, and other indirect costs are allocated based on a ratio of direct allocated labor costs. The department reports that all cost centers will be time studied each quarter on a continuous and rotating basis starting in June 2001, and it will request funds through the budgeting process for any amounts due to the Cal-Vet program from other funds as identified through the allocation process. However, the department does not believe it has reliable data from the past and cannot confidently identify the amount of Cal-Vet funds it has used outside the program in years prior to fiscal year 2000–01.

The department reports it has completed centralizing its loan processing and is reducing the time it takes to process a loan, as well as resolving system issues. Further, it is gathering task data from its own operations and industry standards to be used in developing workload standards, duty statements, and work class specifications for positions in its field and headquarters offices. The department's goal is to have the workload standards implemented after it has determined that staff is in the proper classifications by the end of fiscal year 2001–02. Other future efforts to improve efficiency reported by the department include steps to develop a field office staffing model; updating its loan underwriting manual and employee training plan; and training, certifying, and monitoring mortgage brokers who process Cal-Vet loan applications.

Finding #3: Inadequate management of the Cal-Vet program's new integrated information system increases costs and creates doubt about the reliability of program data.

Another obstacle the department faces in controlling excessive program costs is implementing the Cal-Vet program's integrated information system. This system is intended to provide reliable program and financial data needed to operate the Cal-Vet program. Even though the department has devoted significant time and money to get the system running, the system still does not meet its needs. The department cannot be certain that the system will properly maintain borrowers' file records and accurately accumulate program and financial data because it has not completed necessary testing. The

implementation project has also been marred by problematic management. When key staff left in the middle of the project, management abandoned its original implementation plan and did not ensure staff adhered to prudent project implementation practices.

Furthermore, the department has not adequately safeguarded the data stored in its system by following prudent procedures for approving, testing, and documenting changes to the system software, or provided adequate security over authorized system access to prevent the loss or misuse of information in the system.

We recommended that the department convene a centralized implementation team to ensure the system functions reliably. As part of this effort, we recommended that the department 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 which tasks remain incomplete, and identify steps needed to properly test the modules and the system. We further recommended that the department adequately safeguard program data and assets by implementing a security policy to limit system access to employees who are properly authorized and ensuring access is not incompatible with their other duties.

Department Action: Partial corrective action taken.

The department reports it hired consultants to perform extensive tests of the accuracy of system data and outputs and to review the information technology and business processes employed. The department reports its consultants found that the system accurately calculates critical information and that the data within the system is reliable and can be used with confidence in the department's day-to-day farm and home loan program. In performing their testing, the consultants also identified some processes and procedures that should be strengthened to assure the department does not repeat some of its earlier implementation errors. These include improving the system's user manual and increasing training, and changing control procedures, security policies, and central documentation files. The department is in the process of developing user manuals and has implemented ongoing additional training. In addition, the department reports it is maintaining a central file for documenting its implementation efforts and has developed a method for tracking issues from discovery to resolution. Further, the department has implemented a new change control policy and is continuing to review and develop security policies regarding access to the information system.

CALIFORNIA ENERGY MARKETS

Pressures Have Eased, but Cost Risks Remain

REPORT NUMBER 2001-009, DECEMBER 2001

Audit Highlights . . .

The Department of Water Resources (department) faced an immense challenge in purchasing the net-short energy of the three investor-owned utilities. The department entered into 57 long-term contracts for power with an estimated cost of $42.6 billion over the next 10 years. Although the energy crisis has now eased, significant cost and reliability risks remain. Specifically, we determined that:

- ☑ *The speed in which the department entered into contracts in response to the crisis precluded the planning necessary for a power-purchasing program of this size. As a result, it assembled a portfolio of power contracts that presents significant risks that will need careful management to avoid increased costs to consumers.*
- ☑ *The portfolio does not contain sufficient power for peak-demand periods, thus potentially exposing consumers to high market prices if energy supply becomes limited during those periods.*

continued on next page

Assembly Bill 1 of the 2001–02 First Extraordinary Session (AB IX) directed the Bureau of State Audits to conduct a financial and performance audit of the Department of Water Resources' (department) implementation of the Purchase and Sale of Electric Power Program (power-purchasing program). The California energy crisis, which peaked between late 2000 and mid-2001, was unprecedented. Energy prices rose to all-time highs, and blackouts occurred in several instances. The State's three largest investor-owned utilities soon experienced credit problems and had difficulty convincing energy power generators to sell electricity to them.

In response to the crisis, the Legislature authorized the department to purchase the net-short energy for the three largest investor-owned utilities. The net-short energy is the difference between the power that the investor-owned utilities provide and consumer demand, an amount that varies considerably. Through September 2001, the department spent $10.7 billion purchasing the net short. While the department managed to provide the needed electricity, we found it was not prepared for the immense task and is still building its capacity for a power-purchasing program of this size. To reduce the State's dependency on volatile spot market prices, the department entered 57 long-term power contracts at a total value of approximately $42.6 billion over the next 10 years. However, the portfolio of power purchase contracts the department assembled contains cost and legal risks that must continue to be carefully managed, and most contracts do not provide the reliable power intended by AB 1X. Specifically, we found:

Finding #1: The department's contract portfolio contains cost risks that must continue to be carefully managed.

The portfolio that the department has assembled as a response to the crisis emphasizes year-round energy but does not similarly emphasize delivery during peak demand hours. The risk in the portfolio that the department must carefully manage is that the portfolio leaves it exposed to substantial market risk in high peak

- ☑ *The majority of the contracts are not written to ensure a reliable source of power, but instead they convey lucrative financial terms upon the suppliers to ensure that energy is delivered. In addition, the terms of the contracts contain provisions that can increase the cost of power; thus they need careful management to avoid additional costs to the consumers.*
- ☑ *The department lacks the infrastructure needed to properly manage the purchases of the net short, but is taking steps to build up its capabilities.*
- ☑ *Many decisions need to be made about the State's future role in the power market. The department's authority to contract and purchase the net short ends after 2002, yet it or another entity will need to manage the considerable market and legal risks of the power contracts and, if the utilities are not creditworthy, purchase the net short.*
- ☑ *Operational improvements are needed to strengthen the department's administration of the power-purchasing program.*

demand periods if supply shortages occur and to substantial market risk with surplus contract amounts in other hours of the year. Compounding this problem is that many of the contracts are nondispatchable, meaning that the department must pay for the power whether or not it is needed. Further, based on present forecasts from the fourth quarter of 2003 through the first quarter of 2005, the department has procured more power than consumers in Southern California need. Because facilities powered by natural gas produce most of the energy for which the department contracted, the department could also have employed more tolling agreements, which would have allowed the contract price to decrease if gas prices decrease, as is predicted. However, according to the department, before receiving an opinion from the attorney general on February 28, 2001, affirming its authority, the department was not certain that AB 1X authorized it to purchase the natural gas supplies required under tolling agreements. The department is considering various mitigation strategies for these risks and the extent to which the strategies will be successful is unknown at this time.

The department's rush to obtain contracts quickly—it entered about 40 agreements with a value of $35.9 billion in just 30 days—may have played a role in the composition of the portfolio because the department's rush precluded the planning and analysis that are necessary for developing a portfolio of this magnitude. Given the urgency to gain control of power prices and the pace that it chose in reacting to the crisis, the department had little opportunity to conduct the planning that was needed. The choice to move quickly was one of the options that the department could have taken. However, going slower may have resulted in a portfolio with fewer, or less extensive, cost risks to manage.

To effectively plan and manage the economic aspects of its portfolio, we recommended that the department gain a firm understanding of the risks contained in the portfolio. Specifically, the department should conduct within 90 days an in-depth economic assessment of its contracts and the overall supply portfolio that serves customers of the investor-owned utilities. This assessment should occur in conjunction with a legal assessment of the contract portfolio to assure that the department develops an effective overall strategy for contract management. Further, this assessment should focus on how the contracts fit into the overall supply of power and on the contract costs relative to current expectations of market conditions. The department should also establish a planning process that more directly integrates the entire portfolio of supplies serving the customers of the investor-owned utilities with the

contract portfolio. Finally, the department should develop a contract renegotiation strategy that focuses on improving the reliability and the overall performance of the portfolio.

Department Action: Partial corrective action taken.

In response to our audit report, the department states that in September 2001 it began to perform a systematic review of its contracts similar to that recommended by our report. The department further states that it has regularly evaluated the contracts for performance in accordance with the terms, comparison of the contract price to the market price, and accuracy of the invoices. The department states that this evaluation has included a comparison of the portfolio to the projected needs for the net-short energy and ancillary services based on the changing needs of consumers. In addition, the department states that in October 2001, it commenced development of a renegotiation strategy, based in part upon the systematic evaluation of the contracts noted above. Its legal counsel is assessing this evaluation, and associated actions and discussions with the department's counterparties are planned. However, as we noted in our comments on the department's response to the audit, the weaknesses in the department's approach is that it has yet to obtain a fresh set of legal eyes to review these contracts to bring an unbiased perspective to the contract renegotiations.

Finding #2: The department's power purchase contract portfolio may not always provide for the reliable power intended by AB 1X.

Most of the contracts that the department has entered with power generators do not include the terms and conditions that one would expect to see in agreements that ensure the reliable supply of energy. A key goal of AB 1X is for the department to obtain a portfolio of power contracts to supply a reliable source of power at the lowest possible cost so that the State could address the unprecedented financial and supply emergency in its electricity markets. When measuring the adequacy of the terms and conditions of the contracts, we analyzed them to determine whether the contracts assure reliable delivery of power in times of high prices and tight supply.

Our detailed review of 19 transactions, constituting 61 percent of the total gigawatts purchased, and a screening of others concluded that most of the power supplies fall under contracts with terms

and conditions that may not always assure that reliable sources of power will be available to the department. For example, under the terms of most of the contracts, the department cannot terminate the contract or assess penalties even if generators repeatedly or intentionally fail to deliver power at times when the State urgently needs power. Instead, the department can only recover the difference between the contract price and the cost of the replacement power. The right to terminate the agreements when generators repeatedly fail to deliver would have provided the department the leverage to compel generators to deliver power in times of severe need or to replace generators with other, more reliable generators.

The department's contracts also often lack terms and conditions that would better ensure other reliability goals of the contracting effort. For example, they lack provisions that would better ensure that generators are making appropriate progress on building the facilities that will supply the power for which the department has contracted and allowing the department to inspect facilities that the generators say are unable to produce power because of mechanical difficulties. Moreover, the contracts may not always ensure that when the State pays a premium for construction of new generating facilities, the new construction occurs and the generators actually make available and deliver the power produced by the new facilities.

Although the department was in a weak bargaining position because of the financial crisis in the electricity markets, its rush to ease the electricity crisis by locking in power supply through long-term contracts weakened its position even further. In its request for bids, the department did not request contract terms and conditions that are standard in the power industry for entities that must ensure reliable delivery of power. We found that in later contracts sellers agreed to terms and conditions that better assure reliable power delivery. Because the department apparently did not ask for certain reliability terms recognized by the power industry until after it had made the bulk of the deals, we cannot determine whether the department would have been able to obtain more favorable reliability terms in the earlier long-term contracts. We did note that while the terms and conditions improved in the long-term contracts negotiated after March 2001, the department negotiated the vast majority of the power, costing $35.9 billion, before March 2, 2001, during the period in which we found that the terms and conditions regarding reliability of power delivery were least favorable to the State.

Finally, another concern is that the contract costs are not fixed and could rise substantially if the department does not manage its legal risk in anticipation of exposure to potential liabilities and to defaults by energy sellers. For example, the department needs to guard against potential events of default that could expose the State to huge early termination payments. Also, the department needs to protect itself from generator costs that the contracts have shifted to the department. Such costs could include governmental charges, environmental compliance fees, scheduling imbalance penalties, and gas imbalance charges.

We recommended that the department undertake actions to anticipate and manage its legal risk in its contracts. Specifically, to ensure that the department can develop an effective strategy for managing these contracts, it should perform within 90 days in-depth assessments of its legal risk and legal services requirements. Further, to make certain that its legal assessment and representation is on par with those of the other parties participating in the contracts, the department should establish an ongoing legal services function that specializes in power contract management, negotiation, and litigation. When necessary to avoid conflicts, this legal function should be distinct from counsel retained to sell bonds or provide legal advice to the State Water Project. Finally, it should investigate all audit and other rights available to the department under the contracts to assure that it can develop a proper program to enforce the power suppliers' performance.

Department Action: Partial corrective action taken.

The department reports that since September 2001 it has added six additional legal counsel to its team, including three additional internal counsel reassigned from other duties and three outside counsel. These attorneys have the responsibility for evaluation of contract compliance, assessment of the rights of the department under the contracts, and acting as litigation specialists in the event of challenge by counterparties. However, as we noted in our comments on the department's response to the audit, the weaknesses in the department's approach is that it has yet to obtain a fresh set of legal eyes to review these contracts, who would bring an unbiased perspective to the contract evaluation.

Finding #3: The department lacked the infrastructure to carry out the power-purchasing program.

Once the department became responsible for the net short, it began purchasing up to 200,000 megawatts of electricity each day. Through September 2001 the department spent approximately $10.7 billion on transactions for short-term power agreements. However, various factors hampered the department's efforts in its new role, including a dysfunctional market and a lack of infrastructure and experienced, skilled staff. In addition, the department is still developing systems for working with the investor-owned utilities to forecast demand, schedule the least-cost available power, and manage the delivery risks. Consequently, at the same time that the department struggled with purchasing needed power, it also struggled to establish the organization it would need to meet the challenge.

The department also still needs to resolve settlement process problems associated with the energy and ancillary services functions that the department has been conducting and continues to conduct on behalf of the California Independent System Operator (ISO). This resolution is important because under a recent Federal Energy Regulatory Commission (FERC) order, the failure of the department and the ISO to reach agreement on how to facilitate the payment of long-outstanding power obligations may disrupt the future supply of available power in the ISO's short-term markets.

We recommended that the department fully staff the power-purchasing program and consider staffing approaches, including hiring additional consultants and contractors if needed, to assure that personnel shortages do not continue to hinder its operations. In addition, we recommended that the department enhance its skills for market analysis and contract management to properly address the implications of uncertainty on contract portfolio management and power dispatch decisions. The department also needs to develop a transition plan for the orderly transfer of the short-term purchasing and net-short management functions to other entities. Further, it needs to collaborate with the investor-owned utilities to share information about generation sources to ensure the least-cost dispatch of power. As part of this effort, the department should coordinate with the investor-owned utilities and the California Public Utilities Commission (CPUC) to ensure that the rate incentives associated with utility-retained generation scheduling are resolved to support the dispatch of the lowest cost energy. Finally, the department should collaborate with market

participants to resolve settlement process problems associated with the energy and ancillary services functions that the department conducts on behalf of the ISO.

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

The department states it is committed to working with the investor-owned utilities, ISO, and the CPUC to develop the proper incentives for the utilities to dispatch power in a manner which those power resources and the department's contracted supply can be reasonably optimized. The department reports that it began working with market participants to resolve payments related to the settlement process and had reached a tentative agreement with the parties involved. However, these efforts were negated by a November 2001 FERC order that required the ISO to bill the department for the settlement payments. As a result, the department believes it will need to continue working with market participants to resolve this issue. The department's response did not address our recommendations regarding the need for a transition plan for the short-term purchasing function or the need to address its staffing and infrastructure weaknesses.

Finding #4: Many decisions are needed regarding the future role of the State in the power market.

The governor, the Legislature, and the department need to make many decisions about the future role of the State in the power market. Now that the crisis has eased, the Legislature and the governor should consider how best to serve the power requirements of the State's consumers over the long term and how best to manage the costs and mitigate the risks of the power contracts. A plan for the State's future role in the power markets is necessary regardless of whether the department continues to manage the program or whether the program becomes a separate state agency or a different type of governmental entity.

The Legislature will also need to evaluate whether to extend the department's responsibilities beyond January 1, 2003, to allow time for present uncertainties that affect these decisions—such as the financial health of the investor-owned utilities and the role of the new state power authority—to be resolved. Other relevant factors that decision makers must consider include the fact that current long-term contracts do not permit the State to renegotiate or quit contracts that become burdensome or unfavorable and whether the department can assign contracts to other entities. Further, the

Legislature needs to take into account the ability of the administering entity to protect the interests of power programs before regulatory bodies to minimize regulatory risks. Even though the CPUC and FERC do not directly regulate the department, their actions have substantial bearing on the market within which the department operates, the load and services for which the department is responsible, and the collection of revenue. Thus, the department needs to actively manage the regulatory risks that result from CPUC and FERC actions. In addition, the department still needs authority to enter financial transactions to manage gas and electric transaction risks.

We recommended that the Legislature and governor consider developing a comprehensive, long-term strategic framework for the electricity industry in the State and for the department's role in that system. We also recommended that the Legislature consider extending the department's purchasing authority to allow time for the development and implementation of a strategic framework and to assure continuity of the purchasing authority and an effective transition, presumably back to the investor-owned utilities.

Additionally, we recommended that the department develop a strategic plan for the future of the power-purchasing program, including an assessment of the transition processes needed to allow orderly transfer of functions to the ISO, the investor-owned utilities, and others, as appropriate. The department should also continue its efforts to coordinate work with the newly created power authority to clearly establish their respective roles and responsibilities. In its future efforts to protect the interests of the power-purchasing program, the department should retain independent counsel to advise it on matters relating to state and federal regulatory issues. Further, the department should perform a comprehensive assessment of its collaboration with the attorney general, the Electricity Oversight Board, the CPUC, and other state entities to ensure that the interests of the power-purchasing program are distinctly and adequately represented in regulatory proceedings. Finally, we recommended that the department seek clear statutory authority to use financial instruments to manage natural gas and electric gas risks.

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

The department states that it has already commenced a program to assure timely transition of its power-purchasing role to others. It assumes that the investor-owned utilities will resume the obligation to purchase the net short when they become creditworthy, the timing of which is uncertain. The department further states that the CPUC has initiated a proceeding to address the process for returning the role of purchasing the net short to the investor-owned utilities and that it is cooperating with the CPUC staff in this effort. In regards to actively managing regulatory risks, the department reports it already has multiple legal firms providing advice on state and federal regulatory matters. The department agrees that it should gain clear authority to use financial instruments to manage gas and electricity risks and indicates that it is in the process of obtaining legal clarification of the existing statutory authority included in AB 1X from the attorney general. The department's response did not address how it would clarify its and the power authority's roles and responsibilities.

Finding #5: The department needs to improve other capabilities in its administration of the power-purchasing program.

We noted that the department needed to make other improvements in its administration of the power-purchasing program. Specifically, we observed the following:

- Although the department has entered into servicing agreements with the investor-owned utilities, it lacks processes to evaluate their performance in estimating consumer demand for power and the department has not developed procedures for how to exercise its auditing rights or to obtain reports from the investor-owned utilities. In addition, the department and the investor-owned utilities have not agreed to share market data, which would assist the department in carrying out its purchasing function.

- Although the department has taken steps to prevent conflicts of interest among its consultants and has implemented a policy that requires them to file the State's standard form for disclosure of economic interests, its process has not accounted for all consultants working on the power-purchasing program.

- The department's internal controls were not adequate to ensure that all charges to the power-purchasing program were valid. Further, when the department identified errors, it failed to completely correct the errors. For example, we identified approximately 14,300 hours for which department staff worked on the program, but for which no payroll costs were charged to the program. However, the department only corrected charges for approximately 4,300 hours.

To address these concerns, we recommended that the department take the following actions:

- The department should amend the servicing agreements to include language that promotes accuracy in the investor-owned utilities' estimates of consumer power needs. It should also develop audit procedures to monitor the investor-owned utilities' performance of critical elements of the servicing agreements, such as remittance of cash, allocation of the power the department purchases, and the cost of energy conservation programs. The independent auditors of the investor-owned utilities should perform these audit procedures.

- To help ensure that its consultants do not have potential conflicts of interest, the department should continue its efforts to review potential conflicts of interest among all employees and consultants twice each year and retain a record of its review.

- The department should improve its internal controls to ensure that only appropriate costs are charged to the power-purchasing program and that these costs are supported by evidence of service.

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

Regarding conflict of interests, the department indicated during the audit that it had begun another review of its consultants to ensure that those required to file economic interest forms have done so. The department's response to the audit report did not address our recommendations over the servicing agreements with investor-owned utilities or for improving internal controls over charges to the power-purchasing program.

CENTRAL BASIN MUNICIPAL WATER DISTRICT

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

REPORT NUMBER 2000-115, APRIL 2001

Audit Highlights . . .

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

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

As a result, the district:

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

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

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

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

Finding #1: The district inadequately planned its project.

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

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

District Action: Partial corrective action taken.

The district says it is currently evaluating the cost effectiveness of proposed project expansions and will not recommend expansions that will not be cost-effective according to its analyses. The district does not foresee undertaking large capital projects in the near future.

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

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

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

District Action: Partial corrective action taken.

On July 1, 2001, the district raised its recycled water rates by $10 per acre-foot. The district is continuing to study its recycled water rates and develop ways to analyze the effect of operational changes that will help support future proposed rate increases.

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

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

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

District Action: Pending.

The district is analyzing the out-of-district charge to determine whether it is set at an appropriate level. The related project is not due to come online until summer 2002. The district is also developing a revised reserve policy that addresses changes to its target levels. It is projecting to increase reserves by about $1.5 million by June 30, 2002.

16TH DISTRICT AGRICULTURAL ASSOCIATION

Investigations of Improper Activities by State Employees, Report I2001-1

ALLEGATION I980008, APRIL 2001

We investigated and substantiated allegations that two directors of the board of the 16th District Agricultural Association (association), which is responsible for governing the California Mid-State Fair (fair), and their spouses improperly received prize money after participating in horse show events at the fair. We also substantiated other improper activities. Specifically, we found:

Audit Highlights . . .

The 16th District Agricultural Association engaged in the following improper governmental activities:

- ☑ *Improperly allowed two directors and their spouses to compete in events and accept $9,845 in prize money.*
- ☑ *Deliberately circumvented state rules.*
- ☑ *Two directors violated conflict-of-interest laws by voting on a resolution in which they had a financial interest.*

Finding #1: The association improperly allowed two directors of its governing board and their spouses to compete in fair events and to accept prize money.

Contrary to state rules, the association's management and governing board allowed one director and his spouse to compete in horse shows, even though the director's spouse was a horse show official. The association also improperly allowed another director's spouse to compete in judged events. Although it had been warned not to do so, the association's management allowed the two directors and their spouses to collect approximately $9,845 in prize money from 1995 through 1999 from timed and judged events. In fact, it appears that the association deliberately circumvented state rules. On July 7, 1999, a consultant advised association management that state rules do not allow board members and their spouses to receive awards. However, during a July 21, 1999, meeting, the association's manager told the board that he had sought counsel concerning conflict-of-interest rules but did not obtain any useful information. The board then adopted a resolution that enabled board directors, association management, and their spouses to continue to receive prize money.

Finding #2: Two directors violated conflict-of-interest prohibitions by participating in a decision in which they had a financial interest.

State law prohibits public officials from participating in any governmental decision in which they know or have reason to know they have a financial interest. Despite these prohibitions, two directors violated provisions of this law when they, as members of the board, participated in the decision that resulted in the adoption of a resolution allowing board directors, association management, and spouses to continue to accept prize money at the fair.

Association Action: Corrective action taken.

The association contends that the state rules are vague and ambiguous, that it sought approval of its practices in 1994, and that its management at that time misled the board as to whether it was properly interpreting the state rules. Nevertheless, the association's board rescinded its July 1999 resolution and passed a new resolution that manifests a specific intent to comply with the state rules. In addition, the directors and their spouses agreed to return all awards won and received during the directors' tenure on the board. Furthermore, all association directors, managers, and staff have agreed to undergo training on the state rules as required by the department.

The Department of Food and Agriculture (department), which provides oversight and support to state fairs, does not agree that the state rules are vague or ambiguous. And, the department does not totally agree with the association's characterization of the historical facts at issue in our report. For example, the department has no record that the association ever sought approval of its practices. Nonetheless, the department believes that the corrective measures proposed by the association are appropriate and will continue to monitor the association to ensure that the corrective measures are fully implemented and that the association complies with the state rules in the future.

KERN COUNTY ECONOMIC OPPORTUNITY CORPORATION

Poor Communication, Certain Lax Controls, and Deficiencies in Board Practices Hinder Effectiveness and Could Jeopardize Program Funding

REPORT NUMBER 99136, JUNE 2000

Audit Highlights . . .

The Kern County Economic Opportunity Corporation had poor communication, internal control weaknesses, and problems with board practices. Specifically, we found that:

- ☑ *Poor communication between the board and some members of management, including the former executive director, led to the dispute over $581,000 in payments and leave taken for CTO.*
- ☑ *Certain weak controls have allowed $90,000 in questionable costs, the potential write-off of $642,000 in health center billings, and inappropriate loans between grants.*
- ☑ *Vacancies and poor attendance plague the board, limiting its effectiveness. The board also violated open-meeting laws and its own bylaws.*

At the Legislature's request, we reviewed the management-compensation practices of the Kern County Economic Opportunity Corporation (KCEOC), a nonprofit community action agency that administers various programs for low-income, elderly, and disadvantaged residents. The review sought to determine the reasons behind the board and management dispute over $581,000 of payments and leave taken for compensatory time off (CTO) for management employees. In addition, we reviewed internal controls and board practices to determine whether the KCEOC was managing its operations effectively. We found the following:

Finding #1: Poor communication led to the dispute over CTO.

The KCEOC board and certain members of management disagreed on the past policy for CTO payments to management and the extent to which the board knew of the payments. We found that on numerous occasions some members of KCEOC management, including the former executive director, failed to fully disclose these payments and other compensation practices to the board even though they knew the board relied upon them for accurate and complete information. The board shared responsibility for the miscommunication because it did not adequately review and question information received. Further, the KCEOC's independent auditor knew of the payments, but failed to disclose them to the board. The disagreement disrupted KCEOC's operations and resulted in the executive director's resignation. Another problem facing KCEOC is that federal and state agencies providing some of its funding could require repayment of the CTO payments and leave taken, which totaled $581,000, because they violated agency policy.

To improve the communication and relationship between the board and management, we recommended that the board make clear requests for information, identify the key issues for its review, and document its actions and decisions for future members. Management, in particular the executive director, should keep the board fully informed by being forthright and disclosing all relevant information on crucial topics. In addition, the board and management should clarify their understanding of any issue so both sides know each other's position. KCEOC should also contact funding agencies to determine if they will require repayment of the CTO paid and work out a repayment plan if necessary.

KCEOC Action: Corrective action taken.

KCEOC reports that it has taken several steps that it believes have resulted in an excellent relationship and meaningful communication between the board and management staff. These steps include revising board reports to contain complete and detailed information about management's activities; developing a process for formally documenting board requests for information; establishing set times for board subcommittee meetings and requiring all primary KCEOC staff to attend; and participating in joint board and management planning sessions, training courses, and seminars. KCEOC has also developed a new board training manual and in August 2000 adopted a new employee manual to clarify management compensation practices. In regards to the $581,000 of CTO paid to management employees, the agencies funding KCEOC have determined that the payments will not be disallowed.

Finding #2: KCEOC spent grant funds for unallowable costs.

KCEOC improperly spent $90,000 of grant funds to pay costs that granting agencies have disallowed for not meeting the requirements of the federal grants. The costs include $60,000 of accountant and attorney fees related to the CTO issue and $30,000 to repay disallowed bonuses it had previously granted to Head Start employees. Granting agencies could require KCEOC to repay these costs.

We recommended that KCEOC contact granting agencies to discuss the allowability of these costs and, if needed, work out a repayment plan. Further, we recommended that KCEOC train board and management on federal cost principles and grant requirements, require staff to carefully review proposed expenditures for adherence to these guidelines, and obtain permission in advance for questionable charges.

KCEOC Action: Corrective action taken.

KCEOC indicates it has received approval for the $60,000 of accountant and attorney fees, but is still negotiating with the California Department of Community Services and Development for the previously disallowed bonuses of $30,000 paid to Head Start employees. To ensure that staff critically evaluates expenditures in the future, KCEOC has conducted internal training courses and sent several board members and management staff to seminars on program management and fiscal controls. KCEOC reports that it is now contacting granting agencies before making any questionable expenditures.

Finding #3: Mismanagement of the KCEOC health center's billings may result in a loss of $642,000.

Mismanagement at the health center resulted in a backlog of approximately $642,000 in billings that were old and possibly uncollectable. In addition, even though the board was concerned about the health center's finances, neither management nor KCEOC's independent auditor disclosed the billing problems to the board. These uncollected billings aggravated KCEOC's cash-flow problems because it had to provide subsidies totaling $1.1 million to the health center since 1993.

To address the backlog and prevent future problems, we recommended that KCEOC contact private and governmental insurers to recoup at least part of the old billings, promptly bill for services and follow up on overdue payments, and, if needed, add staff to alleviate the billing workload. We also recommended that the board receive regular reports on billings along with an estimate of how much is collectible.

KCEOC Action: Corrective action taken.

KCEOC reports that it has hired a new health center manager with extensive experience in health care management and that billings are now current. It also contacted insurers to determine if they will honor billings that are over one year old, but its requests were denied and it will write off these billings. In March 2001 KCEOC implemented a new clinic computer system to allow better management of accounts receivable. Finally, clinic staff received training to ensure accurate billing for services.

Finding #4: KCEOC made inappropriate loans between grants to cover temporary cash deficits.

Because KCEOC did not manage its cash to ensure a steady flow of funds to each program, it inappropriately lent funds from grant programs with positive cash balances to meet the demands of others with temporary deficits. Our review of program cash balances found eight occasions during 1998 when KCEOC appears to have used funds from other grants for programs with deficit cash balances. In addition, KCEOC regularly lent grant funds held in reserve to other grants with temporary cash deficits. By lending restricted cash balances, KCEOC was violating its grant agreements and risking sanctions by granting agencies.

We recommended that KCEOC discontinue lending funds between grants, develop procedures to better anticipate the cash needs of programs, limit cash expenditures of grants to their existing cash balances, and provide program managers with the financial information needed to better manage their cash needs.

KCEOC Action: Corrective action taken.

KCEOC reports that the practice of lending grant funds to cover other grant deficits has been discontinued and that the board now receives more detailed information on cash balances to identify problem areas. In addition, accounting staff have trained managers how to more effectively monitor program expenditures, budgets, and cash needs.

Finding #5: Other control weaknesses, including lack of an effective inventory system at the food bank, place assets at risk.

The food bank lacked an effective inventory system to keep track of donated foods and to properly manage donated food. Further, some food bank volunteers inappropriately consumed or set aside donated foods and the food bank did not always secure or segregate valuable items to reduce the risk of theft. Minor control weaknesses that were not individually significant, but collectively weaken internal controls, included a failure to establish and update formal accounting policies, a lack of appropriate approvals for some expenditures, security lapses, weaknesses in personnel practices, and costs that were questionable under federal guidelines.

We recommended that KCEOC take steps to strengthen inventory controls at the food bank and implement controls to address the other weaknesses that we found.

KCEOC Action: Partial corrective action taken.

To address our concerns at the food bank, KCEOC indicates that it implemented a new inventory system, fenced a portion of the warehouse to secure valuable food items, hired additional staff to assist in organizing and managing inventory, and hired a safety specialist to address safety issues at all KCEOC facilities, including the food bank. In addition, KCEOC established a committee to study ways to improve inventory control and to develop policies to govern staff and volunteers. In regards to the other minor control issues we noted, KCEOC is preparing administrative and accounting manuals, asking its independent auditor to review its compliance with grant requirements, and training staff on timesheet procedures and internal controls.

Finding #6: KCEOC has weak internal oversight of its operations.

We found that internal oversight of KCEOC's operations was weak for several reasons. Because program managers lacked fiscal training and reports for their grants, too much responsibility for fiscal monitoring rested with KCEOC's director of finance. In addition, the KCEOC board placed too much reliance on external reviews to perform oversight of agency operations. These reviews are supposed to ensure that funds are being spent according to regulations and to identify significant control problems. However, these reviews are not comprehensive and KCEOC had not regularly changed the audit firm it used for its annual single audit to ensure a fresh look at KCEOC's operations. Finally, the board had not always ensured that management followed up on problems identified during external reviews.

To address the overreliance on the director of finance, we recommended that KCEOC provide fiscal training to managers and board members and provide managers with more informative financial reports about their programs. In addition, we recommended that the board consider creating an internal auditor position that would report to the board to follow up on problems noted in external reviews and work to improve and maintain the control environment of the organization. Finally, KCEOC should change auditors regularly to ensure that the annual single audit adds value and provides a fresh perspective on agency operations.

KCEOC Action: Partial corrective action taken.

To improve internal oversight of operations, KCEOC hired a new independent auditor and indicates it will seek a new firm every three to five years, provided training to the board and KCEOC staff, and is in the process of preparing administrative and accounting manuals. KCEOC explored the feasibility of hiring an internal auditor, but decided against doing so at this time because it believes its other actions to improve controls will be sufficient.

Finding #7: Persistent absences and vacancies hinder the board's oversight.

The KCEOC board had persistent problems with member absences and vacancies. Since 1994 board meetings had an average absence rate of 30 percent, which may be a result of the failure to adequately enforce its absence policy. Vacancies consistently occurred in positions designated for representatives of the county's low-income and private sectors. The absences hindered the board's ability to provide effective oversight, while the persistent vacancies could jeopardize the agency's funding because the board must have adequate representation on its board as a condition of receiving certain grant funds.

To address the absences, we recommended that the board counsel members with excessive absences and remove any members that continue to violate the absence policy. Because the board had recently begun to actively recruit new members, we recommended that it continue with these efforts, and if unsuccessful, consider reducing the number of seats.

KCEOC Action: Corrective action taken.

As of June 2001, KCEOC reports that all board positions were filled and that the board had an attendance rate of 90 percent in 2001. Board staff have also participated in fiscal and administrative reviews and training specifically designed for community action agencies.

Finding #8: Board practices need improvement.

Certain board practices needed improvement to ensure that it complied with laws, minimized the risk that officers act inappropriately, and provided more effective oversight. Specifically, the board violated open-meeting laws that apply to local agencies when it held six meetings during August, September, and October 1999

without proper notice to the general public. The board also neglected to keep minutes for five of these meetings—a violation of a bylaw requirement. KCEOC also exposed itself to the risk that the officers may act inappropriately when it changed the bylaws in January 2000 to allow officers to act on the board's behalf. Although the new bylaws require officers to report their actions for consideration and ratification at the next regular board meeting, they do not specify the circumstances under which officers can take these actions. Finally, board members have received little training on how to conduct proper oversight of the agency.

We recommended that the board comply with open-meeting laws and its bylaws by giving advance notice of meetings and keeping minutes of all closed sessions. In addition, the board should explicitly define the circumstances under which officers may act on the board's behalf between meetings. Finally, the board should provide appropriate training to its members to allow them to carry out their responsibilities.

KCEOC Action: Corrective action taken.

The board reports it has reviewed and studied open-meeting laws and is strictly adhering to those laws. In addition, the board has adopted procedures for documenting the minutes of closed board sessions. To address our concern about board officers' actions between meetings, KCEOC has reestablished an executive committee, comprised of officers and up to two other members, to deal with issues when the full board cannot meet. To improve oversight, board members have participated in various seminars and training sessions.

PORT OF OAKLAND

Despite Its Overall Financial Success, Recent Events May Hamper Expansion Plans That Would Likely Benefit the Port and the Public

REPORT NUMBER 2001-107, OCTOBER 2001

Audit Highlights . . .

Our review of the Port of Oakland's (Port) financial statements for the past 10 years and its past and future capital improvement projects revealed that:

- ☑ *Overall, the Port effectively managed its assets, and its $1.7 billion capital improvement program should benefit the public and allow it to remain competitive.*
- ☑ *Its maritime and aviation divisions have prospered, and their expansion plans are based on reasonable estimates of future revenues and expenditures.*
- ☑ *Certain recent events may hamper the aviation division's plans to improve the airport.*
- ☑ *The real estate division consistently operated at a deficit due to unsuccessful business ventures, inaction in controlling operating costs, and the Port's decision to lease certain properties at below-market rates.*

Overall, the Port of Oakland (Port) effectively managed its assets over the last 10 fiscal years (1990–91 through 1999–2000) and its $1.7 billion capital improvement program should benefit the public and allow the Port to remain financially competitive in the future. We found that two of the Port's three revenue generating divisions—maritime and aviation—performed well during the past decade, while the third—real estate—has shown consistent losses. The real estate division's losses were due to some unsuccessful business undertakings, its inability to control its high operating costs, and the Port's decision to lease certain real estate division holdings to public and nonprofit entities at below-market rates.

The Port is also in the middle of planning and implementing large capital expansion plans for both its maritime and aviation divisions. Our review of the Port's March 2000 feasibility study found that projections of the maritime and aviation divisions' future revenues and expenses are reasonable and that their respective expansion plans should provide a number of public benefits. However, events have occurred since the March 2000 feasibility study that may significantly affect the aviation division's plans for improving the airport. For instance, the aviation division had to revise its expansion plan to curb costs when updated construction cost projections proved higher than expected. In addition, an appellate court decision will require the Port to develop a supplemental environmental impact report that will result in added time and expense. Finally, the terrorist attacks of September 11, 2001, could result in costly changes to airport security.

Finding: The real estate division's consistent losses have been due to costly public services, high operational expenses, and some ill-fated business decisions.

Despite two studies and an action plan adopted by the Board of Port Commissioners (board), the real estate division has taken few steps to alleviate the financial drain it has had on the Port's overall operations. From fiscal year 1990–91 through 1999–2000 the real estate division lost between $4.3 million and $12.4 million, for an average annual loss of $7.5 million. These losses appear to result from at least three different factors. The first is a conscious decision by the Port to have the real estate division enter a number of lease agreements at rates significantly below fair market value. The second relates to the high operational costs associated with properties located in and around Jack London Square, costs that the real estate division failed to reduce. The third cause seems to be some ill-fated decisions the division made in pursuing certain business deals.

We recommended that, to reduce the effect of its losses on the Port's overall operations, the real estate division should take the following actions:

- Complete the action plan to improve revenues and reduce operating costs that was approved by the board in 1999.
- Examine the feasibility of increasing below-market lease rates to at least cover its operational costs without harming the Port's relationships with the community and the other municipalities.
- Continue to look for ways to increase revenues and decrease costs associated with managing its assets.

Port Action: Partial corrective action taken.

The Port reports that it is currently working towards implementing two of the items listed in its 1999 action plan. In December 2001 the board approved a transaction to transfer four Port buildings within Jack London Square and the corresponding operations to a third party in March 2002. Now that the board has approved the Jack London Square transaction, the Port is focusing on completing and releasing a Request for Proposal on its Marina portfolio of properties.

Further, the Port reports that it is currently analyzing the below-market leases for strategic options and cost/benefit savings and expects that the board will review this study within six months (July 2002). Finally, the Port stated that it is continuing to look for ways to increase revenues and decrease costs relating to its real estate division.

SAN DIEGO INTERNATIONAL AIRPORT AT LINDBERGH FIELD

Local Government, Including the San Diego Unified Port District, Can Improve Efforts to Reduce the Noise Impact Area and Address Public Dissatisfaction

REPORT NUMBER 2000-126, OCTOBER 2000

Audit Highlights . . .

Our review found that:

- ☑ *Delays in implementing sound-attenuation programs, combined with the city of San Diego's (city) failure to implement certain provisions of a land-use plan, have prevented further decreases in incompatible land use within the San Diego International Airport at Lindbergh Field's noise-impact area.*
- ☑ *The cessation of public meetings by the county of San Diego's Noise Control Hearing Board may have lessened the community's trust of the port district.*
- ☑ *There have been numerous studies about relocating the airport, but thus far, there has been no final decision to move or expand it.*

The Joint Legislative Audit Committee requested that we examine the accuracy of the noise-monitoring data that the San Diego Unified Port District (port district) reports to the Department of Transportation (Caltrans). We were also asked to evaluate the San Diego International Airport at Lindbergh Field's (Lindbergh Field) noise-monitoring and flight-tracking system and the port district's use of that system to respond to complaints. Finally, we were asked to determine the extent to which Caltrans monitors the port district's noise complaint process. We found that state regulations limit Caltrans' role to ensuring that the port district's noise-monitoring system meets state standards, and to reviewing quarterly noise-monitoring data for the purpose of assessing progress towards reducing Lindbergh Field's noise-impact area. Numerous entities have a role in planning, monitoring, or overseeing the noise impact area. We found that:

Finding #1: Implementation of sound-attenuation programs has been slow.

Although the port district has funded improvements to school districts within the San Diego Unified School District, delays in the startup of its residential and military sound attenuation programs have slowed its ability to further reduce Lindbergh Field's impact area. The port district intended to begin upgrading eligible homes in its residential sound-attenuation program in 1999, but was delayed when the city of San Diego's Historical Resources Board voiced concerns about the preservation of homes within the noise-impact area. The port district expects more than 200 residences to receive upgrades by January 2002. However, the port district has made little progress toward implementing its military sound-attenuation program, which is similar to the residential program. In 1999 the port district began working on a potential exchange of property with the U.S. Marine Corps. If the property exchange

is approved, the port district could begin addressing some of the noise issues at the Marine Corps Recruit Depot within two to three years.

We recommended that the port district continue negotiations with the U.S. Marine Corps to resolve noise-related issues at the Marine Corps Recruit Depot.

District Action: Corrective action taken.

The district reports that it has negotiated an agreement with the U.S. Marine Corps that will provide additional acreage to extend the airport's north taxiway. The agreement also includes the construction of a 25-foot high sound wall to attenuate the effects of the taxiway extension and other related airport ground based noise sources on the depot.

Finding #2: The port district discontinued reporting certain data despite a provision in its current variance to do so.

In 1972 San Diego County (county) declared Lindbergh Field a "noise problem airport" in accordance with state regulations. The port district applied to Caltrans for a variance to the noise standards. In accordance with the requirements of the most recent variance, the port district must include in its quarterly reports information such as a report of operations by airline, aircraft type, and stage classification for each quarter and cumulative period ending June 30 and December 31. This data allows interested parties to track the number of aircraft considered to be excessively noisy. In 1999 the port district stopped reporting on operations by airline and aircraft type.

We recommended that the port district continue to report on operations by airline and aircraft type, as the variance requires.

District Action: Corrective action taken.

The district states that information on operations by airline and aircraft type for January 1 through March 31, 2000, has been provided to Caltrans, the county, and when requested, to community members. Further, it states that it continues to include this information in its quarterly noise reports to the county and Caltrans.

Finding #3: The county is not properly monitoring the port district's progress.

State law requires the county to enforce the noise regulations established by Caltrans. The county established its Noise Control Hearing Board (noise board) to enforce the terms and conditions of Lindbergh Field's variance to the noise standards and submit quarterly reports to Caltrans based on information provided by the port district. The noise board also reviews and audits the port district's noise-monitoring data and serves as a forum for public discussion of airport noise issues.

The noise board has not met since April 1999 and, as a result, the port district has been submitting the quarterly reports directly to Caltrans without independent verification. Unless the noise board resumes its oversight responsibilities, there is no independent, local governing body to ensure that the port district is meeting the terms and conditions of Lindbergh Field's variance and that progress toward reducing the noise impact area is acceptable. Moreover, community members affected by Lindbergh Field's noise no longer have an independent verification of the port district's noise-monitoring data.

We recommended that the county reactivate its noise board. It should also ensure that the noise board meets quarterly and submits regular and complete reports to Caltrans.

District Action: Corrective action taken.

The county reports that it has increased its efforts to ensure that the noise board will maintain a regular meeting schedule to review quarterly reports from the port district about the operation of Lindbergh Field. The noise board met in January, April, and December of 2001 to clear the backlog of quarterly reports through the first two quarters of 2001.

Finding #4: The city of San Diego (city) has failed to enforce certain provisions of Lindbergh Field's comprehensive land-use plan.

The comprehensive land-use plan that the San Diego Association of Governments (SANDAG) adopted in February 1992, with a subsequent amendment in April 1994, directs the city to prohibit the development of any further incompatible land uses within the area surrounding Lindbergh Field and to require new projects to be consistent with the plan. In certain instances, property owners

must file an avigation easement with the county recorder and the port district to obtain building permits. Avigation easements are one way of converting land use from incompatible to compatible. However, the city has not consistently obtained avigation easements when required. In fact, it was not until October 2, 2000, that the city council amended an ordinance to include supplemental regulations for Lindbergh Field's land-use plan and update its avigation easement requirements. The ordinance still requires the approval of the Coastal Commission, which oversees local coastal programs.

We recommended that the city should develop procedures to ensure that property owners obtain the necessary avigation easements for new developments within the noise-impact area. It should also make certain that its general and community plans, zoning, and regulations and ordinances are consistent with the comprehensive land-use plan.

City Action: Corrective action taken.

The city reports that its ordinance became effective November 1, 2000, for areas outside of the coastal zone. However, the city did not inform us if it received approval from the Coastal Commission to implement its ordinance for areas within the coastal zone.

The city reports that a process is in place to ensure that staff direct applicants proposing new developments within the noise-impact area to the port district to grant the avigation easement. Also, its staff review environmental documents for certain development projects to ensure that there is a requirement for granting an avigation easement to the port district when an increase in the number of dwelling units or an increase in the noise above a certain level occurs.

Finding #5: SANDAG did not ensure that all the city's regulations were consistent with the comprehensive land-use plan.

SANDAG also bears some responsibility for ensuring that certain provisions of the land-use plan are met. Specifically, the plan requires SANDAG to monitor the city's general and community plans, zoning ordinances, and building regulations. Five years after the adoption of the plan, port district staff recognized the omission of Lindbergh Field from the city's ordinance. Although the omission eventually was corrected, SANDAG's failure to ensure that all the

city's regulations were consistent with the plan before 1997 contributed to the city's delays in seeking the necessary avigation easements to reduce incompatible land developments.

We recommended that SANDAG comply with the plan requirements for ensuring that the city's general plan and ordinances agree with the comprehensive land-use plan.

SANDAG Action: Pending.

The SANDAG reports that in October 2001 the governor signed AB 93, which creates the San Diego Regional Airport Authority. The regional authority became effective January 1, 2002, and is responsible for the Land Use Commission and planning and siting a new regional airport. The SANDAG reports that it will cooperate with the regional authority to transfer its responsibilities and planning program.

Finding #6: The port district can improve its community relations.

The public can register complaints through a hotline established by the port district's Airport Noise Management Office. Another forum for residents to voice their concerns is the Airport Noise Advisory Committee (committee), established by the port district in 1981 and composed of 14 voting members from various agencies, industries, and other interested groups. The committee meets at least once each calendar quarter. Any community members wishing to address the committee must do so within a time limit of three minutes.

At the committee's September 14, 2000, meeting, emotions ran high and involved outbursts that were not conducive to rational discussion. The existing format, similar to that of a public meeting, did not appear to generate constructive communication between the port district and the public.

We recommended that the port district encourage more community involvement, such as using working groups that include local citizen representation.

District Action: Corrective action taken.

The port district reports that the Airport Noise Advisory Committee has incorporated a structure that, where appropriate, will include small group forums as an additional communication vehicle to enhance its community outreach program.

Finding #7: The port district can do more to encourage voluntary restrictions of noisier retrofitted stage 3 aircraft.

Significant noise differences exist among the aircraft that comply with stage 3 noise levels. New stage 3 aircraft, such as Boeing 757s, are much quieter than older Boeing 727s with "hushkits," which reduce aircraft engine fan and compression noise through engine modification, acoustic treatment, and noise-suppression technology. The Federal Aviation Administration's position is that hushkit modification is an appropriate method to comply with stage 3 aircraft noise standards. The port district is not able to restrict the access of hushkitted aircraft from Lindbergh Field. However, the Airport Noise Capacity Act of 1990 does allow the port district to seek the air carriers' concurrence to implement voluntary restrictions. In response to a request from the committee, the port district plans to send a letter to aircraft operators urging them to voluntarily substitute noisier hushkit stage 3 planes with quieter stage 3 planes.

We recommended that the port district proactively participate in finding ways to reduce or minimize the use of stage 3 certified aircraft at Lindbergh Field.

District Action: Partial corrective action taken.

The port district informs us that it corresponded with a number of aircraft operators to request their voluntary reduction of hushkitted aircraft operations. Some major air carriers have ceased or limited the use of these aircraft. The district states that it will continue to proactively research ways to reduce or minimize the use of hushkitted aircraft at Lindbergh Field.

Finding #8: Despite projected increases in aircraft operation, no conclusion has been reached concerning the relocation of Lindbergh Field.

In 1996 aircraft operations at Lindbergh Field totaled 220,000 arrivals and departures. Total aircraft operations at Lindbergh Field are projected to grow at an average annual rate of 2 percent through 2020. At this rate, Lindbergh Field will reach its maximum airport capacity of 275,000 by 2011.

SANDAG, in its role as the regional transportation planning agency, is primarily responsible for siting San Diego's commercial airport. SANDAG, community groups, and private individuals have conducted about 30 studies concerning the relocation of Lindbergh Field but have not reached any conclusion.

We recommended that SANDAG, local agencies, and citizen's groups effectively address the anticipated growth in Lindbergh Field's aircraft operations by deciding whether to relocate the airport.

SANDAG Action: Pending.

The SANDAG reports that in October 2001 the governor signed AB 93, which creates the San Diego Regional Airport Authority. The regional authority became effective January 1, 2002, and is responsible for the Land Use Commission and planning and siting a new regional airport. The SANDAG reports that it will cooperate with the regional authority to transfer its responsibilities and planning program.

SAN FRANCISCO PUBLIC UTILITIES COMMISSION

Its Slow Pace for Assessing Weaknesses in Its Water Delivery System and for Completing Capital Projects Increases the Risk of Service Disruptions and Water Shortages

REPORT NUMBER 99124, FEBRUARY 2000

Audit Highlights . . .

Our review of the San Francisco Public Utilities Commission (commission) disclosed:

- ☑ *It has been slow to assess its water delivery system and has made little progress in completing capital projects.*
- ☑ *Since 1994 the commission has known that it needs to identify additional sources of water, yet it did not begin to develop a water supply plan until 1996.*
- ☑ *Several factors contribute to the commission's slow pace for completing capital projects.*
- ☑ *The success of the commission's capital improvement program is uncertain because it is still developing some plans while it has only recently implemented others.*

The San Francisco Public Utilities Commission (commission) has been slow to assess and upgrade its water delivery system to survive catastrophic events such as earthquakes, fires, or floods. Some parts of the system, such as critical pipelines, are nearly 75 years old and are in dire need of repair or replacement. The commission has also been slow to estimate the amount of water that it will need to meet future demands and to seek additional sources of water. As a result, the nearly 2.4 million people in the city and county of San Francisco, and in the counties of Alameda, San Mateo, and Santa Clara who rely on the commission for their drinking water are at a greater risk of disruptions or water shortages if an emergency or drought occurs.

The commission's capital improvement plan lists about 200 projects requiring more than $3 billion to complete. The commission plans to complete most of these projects over the next 15 years. In the past 10 years, however, the commission has completed only 54 projects at a cost of about $270 million. Several factors contributed to the commission's inability to complete capital projects more quickly. Specifically, we found:

Finding #1: The commission needed to identify alternatives for managing its capital improvement program.

Recognizing that the water delivery system has significant weaknesses that will require large-scale improvements, the commission was seeking approval to contract for the services of a program management consultant. Basically, it was counting on the consultant to perform a major overhaul of the commission's engineering and construction operations so it could implement the capital improvements necessary to ensure system reliability. At the time

of our report, it was unclear whether the commissioners or San Francisco's board of supervisors would approve this contract. If they did not approve the contract, we believed that commission staff might be ill-equipped to handle such a large, complex capital improvement program.

We recommended that the commission be prepared to take alternative action if the commissioners or the board of supervisors decided to not approve the contract for its program management consultant.

Commission Action: None.

On August 28, 2000, San Francisco's board of supervisors approved a four-year contract to provide program management services for the commission's capital improvement program. A notice to proceed on the contract was issued on September 20, 2000.

Finding #2: The commission was slow to assess weaknesses in its water delivery system and to create a comprehensive water supply master plan.

The commission was slow to assess the ability of its water delivery system to survive catastrophic events. Since at least mid-1993, staff members had raised concerns about the ability of portions of the water delivery system to survive a major earthquake. However, despite starting a review of the system's reliability in 1994, the commission had completed only two of the three planned phases of the study by January 2000. The commission had also been slow in identifying additional sources of water. Droughts in the late 1970s and early 1990s indicated that the commission could not provide the amount of water it believed it could. Peak summer water demands and suburban population growth pointed to the need for additional water supplies. Having started a study to identify new water sources in 1996, the commission expected to complete a water supply master plan by early 2000. Delays in completing these studies contributed to delays in improving system reliability.

We recommended that the commission complete its facilities reliability study and the water supply master plan.

Commission Action: Partial corrective action taken.

The commission states that the third phase of the reliability study is now underway, using commission staff and the program management consultant. The commission also reports

that its water supply master plan was approved in May 2000 and that it is implementing projects in accordance with its capital improvement program plan and available funding.

Finding #3: Staff shortages contribute to project delays.

The commission's former general manager stated that a shortage of qualified personnel led to delays in project schedules. The commission took some measures to address its staff shortages such as increasing the number of personnel staff and providing them with training on San Francisco's personnel processes, suggesting improvements to the hiring procedures for engineers used by San Francisco's department of human resources, and obtaining approval for several contracts to supplement its engineering staff. Although the commission did not provide sufficient data to substantiate its staff shortages, we believed that the commission must ensure that it has sufficient staff to complete its capital projects.

We recommended that the commission continue pursuing ways to attract and retain qualified engineering staff.

Commission Action: Corrective action taken.

The commission reports that it continues to hire staff to meet the needs of its divisions and that it will hire staff according to workload, availability of qualified candidates, budget authority, and funding. Since 1999 it has hired 65 new engineers and 12 new project managers. The budget for fiscal year 2000–01 contains funds for 20 new positions, including engineers. Also, the commission states that it is meeting on a regular basis with the staff of other city departments that have significant engineering staffs to identify potential resources for projects. Finally, the commission states that hiring in its engineering bureau has improved. In February 2001 it had only 60 vacancies (26 percent of 230 positions) while in 1999 it had 95 vacancies (48 percent of 200 positions).

Finding #4: The commission's contracting procedures are inconsistent.

As early as May 1997 a consultant reported that the commission's contracting process took twice as long as another city department, noting that the commission's decision-making process contributed to delays. We found that the commission had begun to address the consultant's concerns by establishing a policy that clarified the approval process for contracts, centralizing the contracting unit

within the commission's utilities engineering bureau, and submitting a budget proposal requesting the creation of a commission-wide contracting unit and the addition of more staff to expedite the internal handling of contracts. However, some commission staff members told us that the contracting process was still slow, adding unnecessarily to the time required to complete projects.

We recommended that the commission continue its efforts to improve its contracting procedures and to train new staff to understand the new procedures. We also recommended that the commission establish a commission-wide contracting unit.

Commission Action: Corrective action taken.

The commission states that it has streamlined contracting procedures and flowcharts, revised dispute-resolution procedures, developed a standard invoice, and conducted workshops on the various types of contracts used. It also reports that staff will continue to use these contracting procedures as well as conduct workshops for other operations. Further, the commission states that a commission-wide contracting unit began operating in April 2000.

Finding #5: Steps for completing projects lack uniformity.

The commission lacks current project operations procedures. Its written procedures for managing capital projects are outdated and many of its forms and templates are no longer used. Implementing common procedures will enhance the consistency, coordination, and effectiveness of the commission's operations. The commission was updating its project operations manual during our audit and expected a final version to be completed by June 2000.

We recommended that the commission continue updating the manual its staff members are supposed to use for guidance during planning, design, or construction of capital projects. We also recommended that the commission ensure that applicable employees receive training and understand the new procedures.

Commission Action: Corrective action taken.

The commission reports that its manual is complete and has been distributed to staff as of August 2000. It also states that project managers are being trained to use the manual as part of the project manager training program.

Finding #6: The commission does not have an effective tracking system to monitor preventive maintenance.

In 1994, San Francisco's budget analyst criticized one of the commission's divisions for performing practically no preventive maintenance on some facilities, stating that the primary reason was that staff members were not fully implementing the automated maintenance-management system. More than five years later, we found that division staff members still were not using the automated system's tracking component. Routine preventive maintenance is essential for ensuring that existing water delivery system components last as long as possible. During our audit, the commission was in the midst of implementing a new automated system. It expected the new system to be fully implemented at the three water-related divisions by March 2000.

We recommended that the commission complete the implementation of its new automated maintenance-management system at all three water-related divisions. We also recommended that the commission train its staff on the new system and ensure that they use it consistently and properly.

Commission Action: Partial corrective action taken.

The commission reports that the new automated maintenance-management system became operational in June 2000 and that training for staff in the operating divisions is complete. The commission did not address how it would ensure that its staff would use the new system consistently and properly.

Finding #7: Project managers receive little training.

Although project managers typically receive on-the-job training, the commission does not have a formal program to train them. In fact, it had not provided formal project management training in the last 10 years. Ongoing, formal training is crucial for ensuring that commission staff members develop and improve their technical proficiency and project leadership abilities.

We recommended that the commission develop and implement a formal training program for project managers and ensure that they receive adequate training while this program is under development.

Commission Action: Corrective action taken.

The commission reports that it prepared a project management curriculum and manual and developed a formal training program. The first classes were held during the summer and fall 2000. A second set of classes was held from March through June 2001. The commission plans to offer classes every year.

Finding #8: The commission's long-range financial planning is incomplete.

One of the commission's primary challenges is funding its large-scale capital improvement plans. A consultant developed a long-range financial report to assess financing options for capital projects for two of the commission's three water-related divisions. This report relied heavily on the commission's ability to obtain voter approval for revenue bonds without adequately addressing contingencies should voters reject future bond measures. This is important because, based on recent voter turnouts, fewer than 100,000 San Francisco voters could deny the commission's bond measures. Also, the projections used in the report were based on current interest rates; changes in these rates could affect the commission's ability to accomplish the plan. Finally, the long-range financial report for the third water-related division was still being developed. As a result, despite identifying many capital projects needed to upgrade its water delivery system, its plans remain incomplete regarding exactly how it will fund these projects.

We recommended that the commission complete and adopt a long-range financial plan for the three water-related divisions. We also recommended that the commission continue to monitor and adjust this plan as necessary. The plan should include more detailed descriptions of the steps the commission should take if San Francisco's voters fail to approve the bonds or if economic conditions change.

Commission Action: Partial corrective action taken.

The commission stated that it presented a draft long-range financial plan to the commissioners in late February 2001. It also held four workshops with the commissioners and the public. The commission stated that it will integrate the plan with its capital improvement program and planned to present the final package to the commissioners for a decision on July 10, 2001. The commissioners began their review on July 24, 2001.

Finding #9: The commission's capital improvement plans are not complete.

The commission's staff and its consultant have developed capital improvement plans for each of its water-related divisions. However, the commissioners have not adopted these plans. Further, the commission has not integrated these plans to obtain an accurate picture of the entire system's needs. Finally, the capital improvement plan for the Hetch Hetchy Water and Power Division was incomplete because it lacked cost estimates for some of its water-related projects. This is significant because this division supplies about 85 percent of the commission's water. Without formal adoption and integration of these plans, we were concerned that other issues could divert the commission's attention from its goal of improving the reliability of the water delivery system by focusing on the most critical projects.

We recommended that the commission complete the missing cost and schedule estimates for the Hetch Hetchy Water and Power Division's capital improvement plan. We also recommended that the commission integrate its capital improvement plans for the three water-related divisions into one cohesive plan and seek formal approval from the commissioners.

Commission Action: Pending.

The commission planned to submit its capital improvement plan (including the cost schedules and estimates for the Hetch Hetchy facilities), integrated with its long-range financial plan, to the commissioners for review in July 2001.

Finding #10: Most of the commission's plans are still in development, while others were only recently completed.

To improve its water delivery system, the commission was still developing many plans while it had only recently completed others when we issued our audit report. These plans included the reliability study, the water supply master plan, the capital improvement plan, and the long-range financial plan. Because of the critical nature of all these plans, we were concerned that delays in completing or implementing any of the plans would jeopardize the commission's ability to upgrade its water delivery system.

To ensure that the commission followed through on plans that it was developing or that it had recently developed, we recommended that the commission report annually to the Legislature and to the Bay Area Water Users Association (BAWUA) for the next five years.

We also recommended that these reports include descriptions of the progress the commission has made in implementing its plans and the accomplishments it has achieved.

Commission Action: Pending.

The commission stated that it will submit an annual report to the Legislature and to the BAWUA after commissioners have approved the long-range financial plan and the capital improvement program.

Finding #11: Executive vacancies and turnover present the commission with a unique opportunity.

The commission recently experienced turnover among some of its executive positions. For instance, from December 1995 through December 1998, the position of manager of the utilities engineering bureau was filled by three different people and was vacant for a total of 13 months. This position leads more than 100 employees responsible for implementing the commission's capital improvement projects. A vacancy in this position contributed to the nearly 3-year gap between the end of the first phase and the beginning of the second phase of the facilities reliability study. Further, at the time of our report, the current manager of the utilities engineering bureau had been on board only 14 months. Other vacancies included the recent retirements of the commission's general manager and assistant general manager for operations. According to the commission's former general manager, it can take 6 months to 12 months to fill these positions.

The commission faces significant challenges in the near future, including the need to implement a huge capital improvement program and to obtain additional water supplies. Without strong, consistent, and effective leadership, the chances that the commission will meet those challenges diminish greatly.

We recommended that the commission appoint to leadership positions individuals who have effectively implemented large-scale capital improvement programs. We also recommended that the commission take measures to ensure it fills available positions promptly.

Commission Action: Partial corrective action taken.

The commission reports that its recruitment efforts continue for the general manager and assistant general manager for operations; a director of finance began work in November 2000. It stated that the appointment of a general manager is continuing (it gave no completion date). The appointment for the assistant general manager for operations will be made after the new general manager is appointed.

GRANT JOINT UNION HIGH SCHOOL DISTRICT

It Needs to Improve Controls Over Operations and Measure the Effectiveness of Its Title I Program

REPORT NUMBER 99130, JUNE 2000

Audit Highlights . . .

Our review of Grant Joint Union High School District's (Grant) administrative practices revealed that it:

- ☑ *Did not obtain the board of trustees' advance approval for certain contracts, although state law and board policy require it to do so.*
- ☑ *Does not have sufficient controls over contracts initiated by its legal counsel.*
- ☑ *Lacks an adequate system to track and safeguard its current inventory totaling more than $32 million.*
- ☑ *Allowed several employees to remain on paid administrative leave for an extended time without always acting promptly to complete the personnel actions being taken against them.*

Moreover, in the past, Grant has not consistently measured whether its Title I, Part A, of the Elementary and Secondary Education Act program is effective.

The Joint Legislative Audit Committee requested that we conduct a comprehensive audit of the Grant Joint Union High School District (Grant) based on concerns that Grant is mismanaged and does not spend funds appropriately. Particular concerns were expressed regarding whether Grant appropriately spent federal funds for its Title I, Part A, of the Elementary and Secondary Act (Title I) program. Grant serves approximately 11,600 students, mainly in north Sacramento County. This report focused primarily on Grant's administrative practices, rather than on any actions it was taking to improve its educational programs. For the areas we reviewed, we found that generally Grant was managed properly and spent funds appropriately. However, it could improve its administrative practices in several areas. Specifically, we found:

Finding #1: Grant's policies do not require the board of trustees (board) to approve certain contracts and purchases in advance.

During 1999, Grant did not submit certain contracts and purchases to the board in advance for approval in three types of circumstances. First, although some members expressed concern that the board was not involved in certain expenditure decisions, board policy requires that it approve only certain types of contracts and purchases in advance. Second, Grant did not obtain board approval for some purchases because it interpreted board policy as not requiring such approval. Finally, Grant failed to obtain the board's approval for other contracts, even though state law or board policy require it. As a result, the board is not involved in any meaningful way with some purchasing and contracting decisions.

We recommended that the board clarify and review its existing policies, decide on the extent to which it desires to be involved in and informed of contracts and purchases, and revise its policies to

meet those expectations. In addition, we recommended that Grant ensure it follows its own policies and state law for obtaining board approval.

Grant Action: Partial corrective action taken.

Grant states that it has clarified procedures in this area and has fully implemented controls over contracts. However, Grant did not specifically address whether the board clarified and reviewed its existing policies. According to Grant, the board now approves all contracts. Specifically, Grant indicated that all first time contracts and any project requiring a contract are preapproved by the board. If the board approves a project, approves the basic parameters for the contract, and authorizes staff to proceed, then a contract is developed based on those parameters, and is signed and ratified by the board.

Finding #2: Grant did not always use a competitive process when required.

Grant sometimes failed to use a competitive process when required by state law and board policies. We found that Grant made three purchases totaling $212,000 in 1999 that should have been bid competitively. Grant failed to use a competitive process for two of the purchases because its purchasing department does not have a procedure to detect orders that it should combine. Grant also did not always follow its own internal written policy for obtaining quotes when it purchases goods and services that do not require formal competitive bidding. As a result, Grant cannot ensure that it received the best value for these purchases.

We recommended that Grant implement procedures to ensure the purchasing department reviews purchases and combines orders when appropriate and submits purchases above the established threshold to a competitive bidding process. In addition, Grant should competitively bid all purchases and contracts required by state law and the board's policies. Finally, Grant should obtain quotes for purchases not requiring competitive bidding in accordance with its internal policies.

Grant Action: Corrective action taken.

Grant notes that it has codified our recommendations in this area into its administrative regulations and has fully implemented them.

Finding #3: Grant has not developed policies for its use of California Multiple Award Schedules (CMAS) vendors.

Grant has not developed policies or procedures to ensure that it compares the prices offered by various vendors when it makes purchases through the CMAS program. Although district staff indicated that they compare and negotiate with various vendors when purchasing goods and services through the CMAS program, they cannot demonstrate that this comparison actually occurred. Furthermore, Grant has not established policies that set limits on CMAS orders it can make. Without obtaining prices from competing vendors, Grant cannot ensure it obtains the best available value. Additionally, since Grant has not set limits on the orders it can make, purchases of any size can be made without requiring staff to seek board approval for any of these transactions.

We recommended that Grant develop policies and procedures to ensure that it compares various vendors when using the CMAS program and that it sets order limits.

Grant Action: Partial corrective action taken.

Grant states that while CMAS purchases do not require bidding, it will require board approval for CMAS contracts or purchases above board policy limits for bidding. Additionally, Grant will follow CMAS guidelines for review of CMAS purchases and contracts. However, Grant does not address whether it plans to develop policies and procedures to ensure it compares vendors or sets order limits.

Finding #4: Grant should improve control over certain agreements.

Grant also could improve its control over agreements initiated by its legal counsel. Grant paid nearly $488,000 for services it received during calendar year 1999 for these types of agreements. Staff did not maintain copies of all agreements, and it appears as though written agreements never existed in certain instances. Additionally, some agreements lacked clear descriptions of the work to be performed and set no limit on the amount Grant was willing to pay for the services. Further, some related invoices did not contain sufficient detail. As a result, Grant does not have a sufficient basis

on which to review the related billings and ensure that it has received the appropriate services. In addition, because Grant did not set a limit on the amount it was willing to pay, it does not have a mechanism in place that, when the limit is reached, would cause staff to review the agreement and determine whether they want to continue to receive the agreed-upon services.

Additionally, all but 4 of 10 advisory services agreements we reviewed failed to identify a specific period of performance. For 2 of the 4 agreements that did define a period of performance, Grant paid for services outside the agreed-upon period. For 1 agreement, Grant also requested that the contractor perform services not specifically identified in the scope included in the original agreement.

We recommended that Grant take the following actions:

- Maintain complete files of all signed agreements and prepare written agreements for all services it requests.
- Include complete descriptions of the work to be performed and rate schedules in the agreements to allow informed judgments as to whether the services were appropriate and allowable.
- Set limits for the amounts it is willing to pay in its agreements to trigger a review and determine whether it wants to continue to receive the agreed-upon services.
- Require all contractors to provide detailed invoices.
- Prepare new agreements or amendments to agreements before it incurs or pays for services not included in the original agreements.

Grant Action: Partial corrective action taken.

Grant states that it has improved quality control over all agreements it negotiates and executes. Specifically, all agreements with vendors, including law firms, consultants, and other service providers must be submitted to the board for approval. Furthermore, all agreements must state with specificity the services to be performed, the cost of the services, and the duration of the agreement. Grant also notes that it has revised its master contract file, which is now maintained in the Business

Services Office and the Legal Services Office. However, Grant does not address whether it plans to require all contractors to provide detailed invoices.

Finding #5: Weaknesses in control over equipment inventory diminish Grant's ability to safeguard its property.

Although Grant is making major equipment purchases through a variety of programs, it has not established an effective system to account for these investments. As of March 2000, Grant's inventory contained more than 83,000 items totaling more than $32 million. We found that Grant has not completed a physical count of its equipment for several years, and its inventory system often does not adequately track the location of equipment. Consequently, it cannot ensure the accuracy and usefulness of its inventory records and lessens its ability to account for and safeguard its equipment against loss or theft. Additionally, Grant cannot ensure the proper use of equipment purchased for a specific purpose.

Additionally, our review of the equipment list indicated that it contains hundreds of items with a value substantially less than the required threshold of $500. By keeping low-cost items in the inventory records, Grant increases the difficulty of tracking equipment and maintaining records for valuable or sensitive equipment.

We recommended that Grant immediately perform a physical inventory of its equipment and update its inventory records. After it updates its inventory records, Grant should then keep them current by developing procedures to track new equipment at appropriate locations and by consistently performing an annual physical inventory. Additionally, the board should revise its current policy to require Grant staff, consistent with state law and federal regulations, to include in its equipment inventory only those items with a value greater than $500 or items determined to be highly susceptible to theft. It also should instruct Grant staff to remove items from its inventory records that do not meet those criteria.

Grant Action: Partial corrective action taken.

Grant is reviewing the inventory and eliminating items that do not meet the $500 threshold or that it otherwise wishes to control. Grant stated that a revised inventory would be available for review in January 2001. Once the volume of items listed is reduced, Grant believes it will be easier to review, maintain, and control the remaining items. At that time, Grant plans to conduct a physical inventory to validate the revised inventory.

Finding #6: Length of paid administrative leave for some employees seems excessive.

Grant does not always ensure that it promptly resolves cases involving employees on paid administrative leave. For example, it could not demonstrate it was engaged in activities that would lead to a resolution of the personnel actions it took for five employees placed on extended paid leave for significant blocks of time during calendar year 1999. Its failure to resolve cases promptly may result in a waste of district funds as it continues to pay the employee on leave. This action may also leave Grant vulnerable to criticism that certain employees receive special treatment.

We recommended that Grant limit paid administrative leave by taking prompt action in disciplinary matters.

Grant Action: Corrective action taken.

According to Grant, since our audit, it has been very aggressive in reviewing and streamlining its human resources procedures, including, but not limited to, administrative leaves. On July 1, 2000, Grant permanently filled the position of assistant superintendent of human resources with an individual who has addressed the issue of paid administrative leave. Grant also states that it intends to expedite investigations and inquiries to minimize the number of days an employee is on paid administrative leave.

Finding #7: Control over background checks and tuberculosis testing of Grant volunteers should be strengthened.

Grant does not always ensure that it adheres to its policies requiring volunteers to submit to background checks and tuberculosis tests before they are given access to school facilities. We found 10 instances in 31 volunteer files in which Grant prepared identification badges for volunteers before it completed one or both procedures. It appears that Grant actually issued the identification badges to the volunteers in 4 of the instances. The badges allow the volunteers access to district campuses, and as a result, Grant may be placing the safety and security of its students, employees, and facilities at risk.

We recommended that Grant tighten its control over the review of volunteers' files and not permit volunteers access to school campuses until background checks and tuberculosis tests are completed.

Grant Action: Partial corrective action taken.

Grant states that its new assistant superintendent of human resources has commenced an audit of all the personnel files to ensure proper compliance with Education Code guidelines as well as its own policies that require a background check and tuberculosis test for all volunteers.

Finding #8: Grant should continue to strengthen its hiring practices.

Although questions arose in the past regarding Grant's hiring practices, it is making progress towards improving them. In 1997, Grant hired a consulting firm to assess the personnel services and the department's hiring procedures and to make recommendations to improve these services. In 1999, Grant contracted with another consultant to, among other duties, assess its progress toward implementing the recommendations of the earlier report. The second consultant found that Grant had implemented many of the original recommendations.

We recommended that Grant address any unresolved concerns identified by the consultants.

Grant Action: Partial corrective action taken.

Grant states that the new assistant superintendent of human resources has further refined the posting, processing, and screening of applications during the hiring process. Grant has also become a member of an organization that provides specific job testing. However, Grant does not specifically address how many of the concerns identified by its consultants are still unresolved.

Finding #9: Grant has failed to measure the effectiveness of its Title I program.

Although it is required to do so by federal law, Grant has not consistently measured the effectiveness of its Title I program. This program provides grants to improve the teaching of children who are at risk of not meeting academic standards. Federal law gives some of Grant's schools flexibility when using these funds. This flexibility, combined with public perception that the Title I program has failed in this district, makes it especially important to measure the program's effectiveness. Currently, in response to more stringent state requirements for achievement testing, Grant is implementing an annual evaluative process for all students. The California

Department of Education believes this process, combined with certain other measures, will meet the Title I requirements. However, it is too early to determine whether the evaluative process will demonstrate that Grant is using its Title I funds in the most effective manner.

We recommended that, as Grant progresses in the development of its overall assessment process, it consistently assess whether its Title I program is effective.

Grant Action: Unknown.

Although Grant indicated that it has reorganized and centralized all of its categorical programs into the Office of Career Development and Special Services under a single Director of Categorical Services, its response does not directly address whether it has implemented an annual evaluative process, which would demonstrate that Grant is using its Title I funds effectively.

LOS ANGELES COMMUNITY COLLEGE DISTRICT

It Has Improved Its Procedures for Selecting College Presidents

REPORT NUMBER 99134, AUGUST 2000

Audit Highlights . . .

Our audit of the procedures used by the Los Angeles Community College District (district) to select its college presidents disclosed that:

- ☑ *In the past, the district followed selection procedures that were generally consistent with each other and allowed for involvement by the college community.*
- ☑ *Its revised procedures improve the accountability of the process, provide for greater community involvement, and are similar to those of other community college districts.*
- ☑ *The district has been slow to replace interim presidents. In four instances since 1995, the district has had an interim president at a college longer than state regulations permit.*
- ☑ *District costs to select college presidents have increased significantly, but are not out of line with costs other districts have incurred.*

At the request of the Joint Legislative Audit Committee, we audited the process the Los Angeles Community College District (district) uses for selecting the presidents for its nine campuses. This report concluded that, although the district followed its Board of Trustees (board) selection procedures, the district did not always hire presidents. In 1999 the district's board rejected the list of finalists forwarded to it by the search committees at Mission and Harbor Colleges and chose instead to appoint interim presidents. The district subsequently revised its selection procedures to increase quality controls and community involvement and conducted new searches that resulted in appointments of presidents at these colleges in 2000. Although the revised procedures are similar to those we identified as "recommended practices" and to those used by some of the 18 California community college districts we surveyed, we found several conditions relating to the selection of college presidents that can be improved. We also concluded that the district's costs to conduct a search process are not out of line with those of other districts.

Finding #1: The district's revised procedures do not explicitly include some recommended practices.

The district's new selection procedures for hiring college presidents, revised in September 1999, improved the accountability of the process by designating a person responsible for ensuring compliance with board procedures and by establishing timelines for the selection process. The new procedures also provided for greater community involvement by, for example, having a greater proportion of representatives appointed from the campus community with fewer board and district appointees on the selection committee. These procedures are similar to those used by some of the 18 California community college districts we surveyed and to those recently developed by the Community College League of

California (league), a nonprofit corporation whose voluntary membership consists of the 72 local community college districts in California.

The district should consider adopting those league-recommended practices that it is not currently using, such as establishing a budget for each search.

District Action: Corrective action taken.

In its one-year response to us dated September 14, 2001, the district stated that it had reviewed the league-recommended practices and while it had considered a number of ideas, the district stated that it generally follows the recommendations.

Finding #2: Although the district encourages open meetings on campus to present the candidates to college employees, students, and residents of the community, open meetings are not always held.

While not requiring such meetings, the district's procedures suggested that these are good opportunities for the committee members to assess how well the candidates and college community would work together and how effectively the candidates would deal with specific concerns at the college. The committee for the recent Harbor College search chose not to have an open meeting. We believe open meetings on campus are an important quality control, as well as an opportunity for more community involvement.

The district should consider making open meetings on campus a standard practice unless the search committee has compelling reasons why such meetings should not be held.

District Action: Corrective action taken.

On August 23, 2000, the board modified its rules to require open meetings to be held for the purpose of presenting presidential finalists to district residents and college faculty, staff, and students. Feedback from these meetings is provided to the board prior to its final hiring decision.

Finding #3: The district's contract with its search consultant does not clearly specify the tasks to which the district and the consultant agreed.

Although the district opted to use a search consultant in the Mission and Harbor College searches completed in 2000, the contract between the district and its consultant was not entirely clear about the specific tasks to which the district and the consultant agreed. In one example, the contract called for the consultant to communicate with the board, but it did not specify the form or frequency of the communication. In fact, we found no written progress reports from the consultant. Although we have no indication of conflict between the district and the consultant over these contract provisions, more precise descriptions of deliverables in the future could forestall potential problems.

The district should ensure that contracts with search consultants include a detailed statement of work and consider including a requirement for consultants to provide periodic written status reports to either the chancellor or the board so the district may gauge their progress and value.

District Action: Corrective action taken.

The district indicated that its request for proposals distributed recently to potential search firms contains a detailed statement of the work of the consultant, and it calls for written status reports to be presented periodically to the chancellor or board. The district stated that these reports are now routinely submitted to the board in its closed sessions.

Finding #4: The district needs to improve its record keeping for its search activities.

We found no evidence suggesting that candidates had been evaluated unfairly in the recent Mission and Harbor College searches. However, the search committee did not always appropriately document its evaluation process. In some instances, we were unable to determine what criteria the committee used to evaluate candidates it had interviewed. Although we saw interview questions, district staff responsible for the conduct of the process could not provide us with any summary of interview evaluations or evidence of whether the finalists were selected by the committee solely based on the interview questions or if other criteria were used.

We believe that the tasks a selection committee undertakes are not only important to ensure that the most qualified individuals are selected as finalists, but also to demonstrate that the process was conducted in a fair and equitable manner. When there is an incomplete record of some of the procedures used in the selection process, the district may not be able to assure critics of the process that the selection was carried out in an appropriate manner.

We recommended that the district archive search documents to demonstrate the district's compliance with all required procedures and to memorialize the process for subsequent searches.

District Action: Corrective action taken.

The district reports that it is archiving the records of recent presidential searches, and holding records of currently active searches, to ensure the information is available for future review.

Finding #5: In the last five years, the district has had four interim presidents whose appointments exceeded the one-year limit.

According to a provision in the California Code of Regulations, no interim appointment of a president may exceed one year in duration. This provision is designed to protect colleges against interim presidents who may prefer to assume caretaker, rather than leadership, roles, and who may be reluctant to make long-term decisions. In addition, if the board appoints an interim president without receiving community input, actions taken by the interim president may have less community support.

Although the regulations allow the California Community College Chancellor (state chancellor) to approve an extension of up to one year for interim appointments if a district demonstrates a pressing business need, the district has not submitted any requests for extensions during the last five years. According to data provided to us by the district, Mission and Pierce Colleges had interim presidents for 25 months and 27 months, respectively, and Harbor College had an interim president for 18 months. The current president of Southwest College is also an interim president, a position she has been filling since August 1996.

The district should perform selection procedures promptly to avoid having interim presidents serve longer than the California Code of Regulations allows. If the district cannot meet this timeline, it should request a waiver from the state chancellor, demonstrating

that it has a pressing business need to continue operating with an interim president. We also recommended that the district develop procedures for selecting interim presidents and submit them to the board for approval. Also, the district should consider whether appointing an interim president who may apply for the position is appropriate.

District Action: Partial corrective action taken.

The district reports that it intends to perform selection procedures promptly to avoid having interim presidents serve longer than the California Code of Regulations allows. In cases where longer service by an interim president is required, the district plans to seek the appropriate waiver, indicating the business need for the arrangement. Regarding the selection of interim presidents, the district believes its interests are best served if it retains the flexibility to devise selection procedures that conform to applicable circumstances as they arise, and refrains from adopting a fixed procedure. The board also articulated its position on the issue of appointing interim presidents who may later become applicants for the regular position. Whenever the board appoints an interim president it will make a determination on the matter based on the totality of the circumstances existing at the time. In its one-year response to us dated September 14, 2001, the district stated that it had used open selection processes, which are similar to the regular presidential selection process, to hire interim presidents.

Finding #6: The district does not have a system to track the costs associated with the search for each of its college presidents.

Although the district was able to provide certain cost information upon our request, it generally does not have a system to track costs associated with each search. The district's costs of selecting a president have risen significantly in the last year, from an average of $6,200 for the searches ended in 1999 at Harbor, Pierce, and Mission Colleges, to $32,000 or more for the searches completed in 2000 at Harbor and Mission Colleges. The Harbor and Mission Colleges searches, which were repeated because of the district's failure to appoint presidents in 1999, were more expensive in 2000 largely as the result of increased travel expenses for candidates and the district's decision to hire a search consultant. However, although the district's search costs increased, its expenses were still comparable to those of other districts performing similar searches.

The district should develop a system to separately track all costs associated with each presidential search. This will allow the district to determine if costs are reasonable and to budget appropriately for future searches.

District Action: Partial corrective action taken.

In its one-year response to us dated September 14, 2001, the district stated that it plans to implement a major upgrade of its accounting system within the next year or two and anticipates that its ability to track the costs of presidential searches will improve greatly. In the meantime, the district is implementing a method of identifying expenses related to individual searches using a simple spreadsheet approach.

LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY

It Can Increase Its Efforts to Ensure the Safe Operation of Its Buses

REPORT NUMBER 2001-101, AUGUST 2001

Audit Highlights . . .

Our review of the Los Angeles County Metropolitan Transportation Authority's management and monitoring of its bus operations revealed that it:

- ☑ *Lacks an effective system to prevent all violations of driving time restrictions.*
- ☑ *Does not adequately track the time its bus drivers work for other employers.*
- ☑ *Has an error-prone accident database that makes analysis difficult if not impossible.*
- ☑ *Does not take full advantage of information on traffic citations to consistently discipline its bus drivers.*

The Joint Legislative Audit Committee requested that we examine the Los Angeles County Metropolitan Transportation Authority's (MTA) management and monitoring of its bus and rail operators. Specifically, we were asked to determine if the MTA complies with applicable federal and state laws designed to protect driver and public safety. We were also asked to review the MTA's procedures for monitoring the secondary employment of its part-time drivers. We found that:

Finding #1: The MTA lacks an adequate system to prevent violations of driving and on-duty time restrictions.

Although state law requires it to ensure that its bus drivers do not exceed established maximum driving and on-duty time limits, the MTA does not generate sufficient information either to be aware of or to prevent all such violations. Federal and state laws dictate bus drivers must not drive more than 10 hours, or for any period after having been on duty 15 hours, and both of these restrictions require a prior off-duty period of at least 8 hours. The MTA's scheduling database generates reports on drivers who work more than 12 hours to ensure that they complete driver logs, but it does not report on the actual driving time. Moreover, because no reports are generated on drivers who work less than 12 hours but drive more than 10, the MTA has no information on those possible violations. Also, the MTA's report on drivers who work more than 15 hours contains numerous errors and thus may not identify time violations. Finally, the MTA cannot use any of the reports, which are generated after the fact, to prevent violations.

The MTA should take the following actions:

- Continue upgrading its Transit Operating Trends System (TOTS) database. In addition, it should further enhance TOTS so it can produce reports that identify all bus drivers who have driven more than 10 hours or for any period after having been on duty for 15 hours.

MTA Action: Pending.

The MTA plans to complete the TOTS upgrade by February 2002. However, the MTA states that it is not technologically feasible at this time to enhance TOTS so it can produce reports that identify all bus drivers who have driven more than 10 hours or for any period after having been on duty for 15 hours. Nevertheless, it will monitor advances in technology and the development of its other systems to seek opportunities for applying this feature.

- Ensure that its division managers review, correct, and re-run the 15-hour report daily so that the report contains accurate information.

MTA Action: Partial corrective action taken.

The MTA states that division staff update the 15-hour report daily. In addition, it believes that once complete, the planned modifications to TOTS will assist management in its review and control of operator hours of service regulations through automation.

Finding #2: The MTA does not effectively track secondary employment.

An important step in preventing bus drivers from exceeding the maximum legal on-duty hours is identifying whether they have employment outside of the MTA (secondary employment), and if so, the types of duties and the number of hours spent with those employers. However, the MTA lacks a database for tracking the secondary employment of its bus drivers, and thus is unaware of drivers who exceed the maximum legal on-duty hours and may cause accidents.

The MTA should take the following actions:

- Enforce its newly established procedures by requiring all divisions to provide, and all bus drivers to complete, secondary employment disclosure letters. These letters should be updated periodically throughout the year.

- Consistently ask for hours worked per week, phone numbers, addresses, and job duty information on the secondary employment disclosure letters. Also, division staff should periodically select a sample of bus drivers and call their other employers to verify the bus drivers' time commitment.

- Develop a database to track those bus drivers who have secondary employment and must submit a daily driver log.

➲ ***MTA Action: Partial corrective action taken.***

The MTA plans to begin using a revised secondary employment form for its drivers to complete in early December 2001 and intends to track them for changes every six months. However, although the form requests certain information about the drivers' other employment such as phone number and name of the company, it does not ask the driver for information such as his or her job duty and number of hours worked per week. Additionally, the MTA did not indicate its actions relating to the development of a database to track those bus drivers who have secondary employment.

Finding #3: The MTA's system for tracking bus driver accidents has flawed data.

In addition to not always knowing when drivers violate on-duty restrictions, the MTA cannot be sure how long drivers have been working at the time they have accidents. Although the MTA tracks the number of bus driver accidents using a database, the Vehicle Accident Monitoring System (VAMS), we found numerous errors in VAMS. Some bus drivers improperly documented the amount of time that elapsed between when they started work and when accidents occurred. In addition, some data entry staff in MTA's bus division did not properly input details from the accident report into the VAMS. As a result, VAMS is not useful to the MTA for analysis that might determine potential causes of bus accidents. In particular, the unreliable data make it impossible to determine whether driver fatigue has contributed to accidents.

To ensure that it captures more accurate accident data, we recommended that the MTA provide refresher training to its bus drivers and data entry staff on how to fill out accident reports and how to enter information into VAMS. Further, it should complete its plans to include controls that ensure drivers' data is coded correctly in VAMS.

MTA Action: Pending.

The MTA hired a safety management consultant to develop a safety improvement workplan. The MTA states that it will implement the plan throughout its organization. The MTA plans to complete the TOTS upgrade by February 2002; but did not indicate whether the upgrades will include controls that ensure drivers' data is coded correctly in VAMS.

Finding #4: The MTA does not take full advantage of information on drivers' traffic citations to consistently apply its discipline process.

State law requires the MTA to participate in a Department of Motor Vehicles (Motor Vehicles) process that gives motor carriers full disclosure, including citations, of any action against a bus drivers' driving record. However, the MTA does not take full advantage of this Motor Vehicles information. Moreover, our sample of driver citations reveals that bus drivers frequently fail to disclose their citations to division managers, despite the MTA's policy requiring them to do so. For example, we were unable to find any evidence that bus division managers were aware of citations for 39 of the 56 bus drivers in our sample. Being unaware of all citations, managers cannot equitably use the discipline process to identify and, if necessary, discharge bus drivers.

The MTA should periodically distribute Motor Vehicles' summary citation data to its division managers so they can readily access all citations relating to all their bus drivers.

MTA Action: Pending.

The MTA has created and distributed two monthly summary citation reports to division managers for review and comment. MTA staff are reviewing the applicability and usefulness of the report with division managers.

LOS ANGELES UNIFIED SCHOOL DISTRICT

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

Audit Highlights . . .

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

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

REPORT NUMBER 2000-125, JULY 2001

The Joint Legislative Audit Committee requested an audit of the Los Angeles Unified School District's (LAUSD) recent reorganization and its executive and administrative compensation practices. We issued our audit report on July 12, 2001. However, LAUSD did not provide its two scheduled responses outlining what corrective actions it has taken to address our recommendations. Therefore, the responses below reflect its initial response to our audit. LAUSD indicated that it found our specific recommendations to be reasonable. Nevertheless, we found that:

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

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

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

➲ ***District Action: None.***

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

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

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

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

➲ ***District Action: None.***

Despite the language in its reorganization plan, LAUSD disagrees with our conclusion that the plan promised a review of every position and that it is necessary to maintain updated job descriptions. Therefore, LAUSD did not indicate it planned to take corrective action in response to our recommendation.

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

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

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

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

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

➲ ***District Action: None.***

LAUSD disagrees with our conclusion on the importance of having guidelines in place when determining the appropriate salary level to award. Therefore, it did not indicate it planned to take corrective action. Furthermore, while LAUSD acknowledged our recommendation that it maintain complete records of its salary determination process, it did not inform us of any corrective actions it planned to take. Finally, LAUSD did not respond to our recommendations to require contractors to submit all contract deliverables and to refrain from basing consultant fees on a position's salary if the consultant is involved in the salary determination process.

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

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

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

➲ ***District Action: None.***

LAUSD did not respond to our recommendation.

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

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

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

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

➲ ***District Action: None.***

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

CALIFORNIA EARTHQUAKE AUTHORITY

It Has Taken Steps to Control High Reinsurance Costs, but as Yet Its Mitigation Program Has Had Limited Success

REPORT NUMBER 2000-133, FEBRUARY 2001

Audit Highlights . . .

Our review of the California Earthquake Authority's (authority) reinsurance costs and State Assistance for Earthquake Retrofitting (SAFER) program disclosed:

- ☑ *The authority's reinsurance costs are high, but not unreasonable compared to what other companies are paying.*
- ☑ *The authority has reduced its reinsurance costs by negotiating favorable contract terms and exercising contract options.*
- ☑ *As of December 2000 only 31 of 3,576 homeowners whose homes needed structural retrofits had made them.*
- ☑ *The remaining backlog of seismic inspections and assessments should be completed and mailed to homeowners by mid-May 2001.*
- ☑ *The authority has spent $3.5 million on SAFER, which is within its statutory requirement.*

The California Earthquake Authority's (authority) reinsurance costs in 1998 represented 90 percent of its policyholder premiums, prompting the Joint Legislative Audit Committee (audit committee) to request that we determine whether the total annual expenditures for reinsurance and capital market contracts constitute a reasonable and appropriate percentage of the authority's annual collected premiums. The audit committee also asked us to examine the authority's implementation of its State Assistance for Earthquake Retrofitting (SAFER) program, an earthquake mitigation pilot program, which is currently in its second phase. We found that:

Finding #1: The authority's high rate in 1998 was due to one-time factors.

In 1998 the authority's rate (the percentage of policyholder premiums it spent for reinsurance) was 90 percent, according to its audited financial statements. This was due primarily to reinsurance costs that were not allocated evenly over the life of its original two-year contract for the first $1.4 billion of reinsurance coverage. The authority's member companies had existing earthquake policies that would be converted to authority policies over the course of its first year of operation. During that year, the authority's exposure level gradually increased until it reached its full amount when the conversion was complete. Therefore, the payment schedule was set up to reflect the fact that the authority would have considerably more risk to cover in 1998 than it had in 1997. Additionally, the contract for the remaining $1.1 billion of reinsurance coverage required the authority to pay for two years of coverage in calendar year 1998. Therefore, although the authority's 1998 rate seems alarmingly high, this rate is due primarily to a high reinsurance premium split unevenly over a two-year contract and a required up-front premium in the second contract.

Finding #2: The authority's capacity to pay claims relies heavily on costly reinsurance.

The authority maintains roughly $2.5 billion in reinsurance coverage, which makes up about one-third of its capacity to pay policyholders in the event of an earthquake. Because catastrophe reinsurance is more expensive than other types of reinsurance, and because the authority must offer earthquake insurance to all qualified homeowners throughout the State, the reinsurance it purchases is costly. The authority's reinsurance costs are higher than other insurance companies because of its unique restrictions. By law, it must offer earthquake coverage statewide, so it cannot reduce its exposure to loss by limiting coverage in geographic areas that are highly prone to earthquake damage.

Finding #3: The authority has taken steps to reduce its reinsurance costs while maintaining the required amount of reinsurance coverage.

According to its lead reinsurance intermediary, hired by the authority to negotiate its reinsurance contracts, the rate-on-line (the amount of compensation the authority currently pays to reinsurance companies to assume part of its risk) is not unreasonable compared to what other companies are paying.

Nevertheless, the authority has negotiated with its reinsurers to reimburse a portion of the premiums on the first layer of reinsurance if they sustained no losses under the contract for calendar years 1997 through 1999. This, coupled with a reinsurance premium adjustment due to the authority's exposure falling below 90 percent of $203.6 billion, resulted in a reinsurance refund of nearly $82 million for its first three calendar years. The authority is also attempting to lessen its reliance on reinsurance by following the advice of its consultant to reduce the amount of coverage it buys and by testing its ability to transfer some of its earthquake risk into the capital market.

Finding #4: The authority faces critical challenges in the future.

The primary challenge that the authority faces is in maintaining its claims-paying capacity. Its reinsurance contracts will expire in the next two years and its authority to assess its member companies up to $2.2 billion when losses exceed its capital will expire in December 2008.

To ensure that it maintains its claims-paying capacity, we recommended the authority continue to monitor the reinsurance market and research alternative financing to reduce its dependence on reinsurance.

Authority Action: Corrective action taken.

The authority had a project consulting team, consisting of five management consulting firms with expertise in insurance, financial, legal, and tax specialties, spend four months reviewing the financial structure of the authority. The purpose of the review was to determine more efficient ways of securing capital, reducing risk-transfer costs, and diversifying the claims-paying capacity of the authority. The consulting team reported its findings to the authority's governing board (board), who has asked authority staff to identify appropriate financial benchmarks for the strength and survivability of the authority based on the assessments of the consulting team. In addition, the board authorized the authority to enter into agreements to provide reinsurance coverage at a lower rate on line in its second reinsurance layer. Finally, the authority's reinsurance intermediaries continually monitor developments in the reinsurance market, and regularly report to the authority.

Finding #5: The authority has not yet captured sufficient data to assess the State Assistance for Earthquake Retrofitting (SAFER) program's effectiveness in achieving retrofits.

The authority has not yet found an effective mix of incentives to encourage homeowners to retrofit their homes, and the number of homes that have been retrofitted is low. Thus, although the authority has spent approximately $3.5 million for the SAFER program, it cannot demonstrate it has achieved its ultimate goal of reducing the State's risk of personal and business economic loss from earthquakes. As of December 8, 2000, only 31, or 0.9 percent, of 3,576 homeowners whose homes needed structural retrofit improvements had completed the needed improvements through the SAFER program. Another 54 homeowners had begun the retrofitting process, but the work was not complete. A telephone survey in January 2001 of 300 homeowners who participated in the SAFER program needs more analysis before the authority can use it to estimate how many other homeowners who received seismic assessments through the SAFER program made some or all of the necessary improvements but did not report them.

Finding #6: The authority has reduced the backlog of seismic assessments for homeowners.

Between October and December 1999, after a great deal of media attention, the SAFER program received nearly 17,000 telephone calls from interested consumers, resulting in 8,304 qualified homeowners interested in receiving a seismic assessment of their homes. To meet this unexpected demand and the resulting backlog of inspections, the authority increased the number of engineering firms that conduct the inspections and prepare assessment reports. As of early December 2000, the authority had spent about $3.5 million for its earthquake mitigation program, had completed roughly 68 percent of the home inspections, and had sent 86 percent of these homeowners their assessment reports. According to the authority, the remaining inspections and assessment reports should be complete and mailed to homeowners by mid-May 2001.

To ensure that the goal of the mitigation program is achieved, we recommended the authority establish a system for determining how many homeowners who participate in the SAFER program complete the recommended retrofit improvements. The authority should also establish a target number of homes to be made seismically secure so it can demonstrate that the goal of the program has been achieved. Until these elements are in place, the authority should delay expanding the program.

➲ ***Authority Action: Pending.***

The authority established a mitigation review committee (committee), which reviewed the current practices of the SAFER program and developed a series of recommendations. Although the authority has not expanded its earthquake mitigation program, only one of the committee's recommendations is related to determining how many homeowners who participated in the SAFER program complete the recommended retrofits. Moreover, none of the recommendations addressed establishing a target number of homes to be made seismically secure by which the authority can demonstrate that the goal of the program has been achieved.

To further encourage homeowners to protect their homes from the peril of earthquakes, we recommended the authority continue to research why more homeowners who received assessment reports have not followed through with retrofitting their homes. Once the authority identifies the reasons, it should make appropriate changes before expanding the program.

Authority Action: Partial corrective action taken.

The authority states that its committee reviewed why more homeowners who received seismic assessment reports did not follow through with retrofit improvements. Although a significant number of respondents indicated a desire to retrofit their homes, a number of homeowners cited financial reasons or other personal circumstances as reasons why they had not followed through with the recommended improvements. Continued education and financial incentives appear to be integral components of follow through with homeowners.

As a result of its review, the committee made a number of recommendations related to the focus of the program, financial incentives, and marketing and education efforts. In addition, the committee provided two long-term recommendations for the authority to partner with employers and local governments to develop additional methods to encourage additional retrofits.

We also recommended that the authority continue to use the information in the SAFER database to develop a strategy to increase the number of retrofits performed as a result of the SAFER program.

Authority Action: Partial corrective action taken.

The authority states that its committee has done some analysis of how the information in the SAFER database can be used to develop a strategy to increase the number of retrofits performed as a result of the program. As the board approved in August 2001, the authority will offer financial incentives to homeowners whose assessment reports identified only water heater strapping problems. The authority will also offer financial incentives to homeowners who bolt their home's foundations or add plywood to its cripple wall (the short wall between the cement foundation and the bottom floor of the house). In addition, the authority will pay part of the standard engineering plans, offer rebates toward construction, and offer free final inspections of completed retrofit improvements.

Finally, we recommended that the authority pursue clarification of its enabling statute to determine whether its limit of 25 staff includes those who work solely on the earthquake mitigation program or whether the program's staff are in addition to the 25 staff the authority is allowed.

Authority Action: Partial corrective action taken.

The authority states that its project consulting team has conducted extensive reviews of the authority and concluded that the limit of 25 staff should be eliminated. As a result, on August 23, 2001, the authority's board directed the authority to pursue legislative changes to the staffing limit.

CALIFORNIA INTEGRATED WASTE MANAGEMENT BOARD

Limited Authority and Weak Oversight Diminish Its Ability to Protect Public Health and the Environment

REPORT NUMBER 2000-109, DECEMBER 2000

Audit Highlights . . .

The California Integrated Waste Management Board (board) cannot fully achieve its mission to protect public health and safety and the environment because it:

- ☑ *Does not have the authority to object to a permit if it believes that additional landfill capacity is unnecessary or that the local governments are not addressing concerns about environmental justice.*
- ☑ *Has approved expansions for landfills even when the landfill owners or operators were continually violating state minimum standards.*
- ☑ *Allows operators who are violating the terms and conditions of their existing permits to continue to do so while seeking approval for revised permits.*
- ☑ *Allows operators to delay closure for extended periods and therefore bypass federal and state regulations.*

The California Integrated Waste Management Board (board) lacks appropriate authority to fully protect the environment and public safety through its oversight of the State's 176 active solid waste landfills (landfills). Also, the board has weakened its ability to properly regulate landfills by adopting policies that contradict state law, not effectively monitoring landfill activity, and allowing extensive delays in landfill closures. These findings concern all Californians because weakly regulated landfill operations carry the potential to contaminate groundwater, release harmful gases into the air, and spread disease through animals and insects that are naturally attracted to landfills. Specifically, we found:

Finding #1: The board does not have the authority to reject permit proposals when additional capacity is not needed.

The board has no express authority to object to an application for a landfill expansion if it determines that additional landfill capacity is unnecessary. However, before it can consider capacity in its permitting process, the board would need to research and resolve certain issues. For example, because the U.S. Supreme Court has found that solid waste is a commodity, the board would need to consider capacity in a manner that would not inadvertently discriminate against the free flow of that commodity on interstate commerce. Furthermore, even if it had the authority, the board does not possess sufficient data to facilitate its decision-making process because its database is incomplete and often contains erroneous and inconsistent data. Additionally, there is no standard method of reporting data, because some landfills report available capacity in tons, while others use cubic yards.

We recommended that the board explore its options for taking into account the necessity for increased landfill capacity as a factor in granting permits. The board also needs to update its database and require local governments to report accurate landfill capacity information on an annual basis in a consistent manner.

Board Action: Partial corrective action taken.

The board did not specifically address whether it plans to consider landfill capacity as a factor in granting permits. The board also did not address when it plans to update its database on landfill capacity, but it did indicate that staff are developing new standards for collecting and maintaining landfill capacity information. During the April 2002 meeting, staff will update the board regarding landfill capacity. Ultimately, the board plans to review capacity data semi-annually.

Finding #2: The board has no authority to reject permit proposals that have environmental justice concerns.

Environmental justice is the fair treatment of people of all races, cultures, and incomes with respect to the development, adoption, implementation, and enforcement of environmental laws, regulations, and policies. Although federal law and recent state legislation attempt to prohibit discrimination in this area, the board does not have the authority to consider or address environmental justice concerns when approving permits, nor does it maintain sufficient data to be able to do so. However, if the board fails to incorporate environmental justice concerns in its permitting process, it cannot ensure that it complies with federal and state laws prohibiting discrimination.

We recommended that the board develop a proposal for incorporating environmental justice into its permitting process and submit the proposal to the California Environmental Protection Agency for its approval. If the proposal is approved, the board should seek legislative authority to object to permit proposals if environmental justice concerns exist. The board should also track demographic information on the communities in which solid waste facilities are located, and make this information available to the public.

Board Action: Partial corrective action taken.

The board indicated that, at the October 2001 meeting, it approved detailed actions that would be implemented immediately to address environmental justice concerns focusing on grant programs, contracts, education, outreach, recycling, market development zones and awards. It also plans to continue to develop other actions to address environmental justice in all its programs. In addition, the board stated that staff have taken the first step toward creating a statewide map by updating location information for active and permitted solid waste facilities. Staff also added the capability to interactively access overlays of census tract demographic information with solid waste facility locations on its Web site. However, the board did not specifically address whether it was seeking legislative authority to object to permit proposals if environmental justice concerns exist.

Finding #3: The board's permit policy does not ensure that landfill operators comply with state minimum standards.

State law requires the board to object to provisions of a permit revision that are not consistent with state minimum standards for solid waste handling, transferring, composting, and disposal, and to return any such proposal to the Local Enforcement Agency (LEA). However, in 1994, the board adopted a policy that it would concur with a permit revision even though violations of state minimum standards might exist. The policy allows landfill owners or operators with long-term violations—those that take longer than 90 days to correct—to continue to operate so long as they demonstrate that the LEA has issued a Notice and Order, the violations do not pose an imminent threat to public health and safety and to the environment, and the operators are making a good faith effort to correct the violations. Despite the board stating that the policy would only apply to long-term violations with no threat to the environment or public health and safety, it has concurred with expansion for four landfills with long-term explosive gas violations that have the potential to harm public health and safety and the environment. Moreover, the board does not have a thorough understanding of whether its 1994 policy significantly affects the environment. In June 2000, it entered into a contract with a consultant to perform a study of the environmental impacts of landfills on air, water, and gas.

We recommended that the board discontinue the use of its 1994 policy. If the board believes this policy is necessary, it should request the Legislature to grant it the authority to issue permits to long-term violators under defined circumstances. Furthermore, the board needs to complete its study of the environmental impacts of landfills in the State.

Board Action: Pending.

During the January 2001 board meeting, the board directed staff to develop regulatory concepts that address the issues within its 1994 policy. The board planned to consider possible regulatory concepts at its December 2001 meeting. In addition, the contractor the board engaged to study the environmental impacts of landfills, indicated during the April 2001 board meeting that it would complete the required tasks for phase I of the contract by January 2002. However, as of February 22, 2002, according to the board, the contractor has not yet completed the phase I task.

Finding #4: The board's enforcement policy allows operators to circumvent the law.

In 1990 the board adopted a permit enforcement policy to resolve a statewide problem with out-of-date permits. The policy required LEAs to issue Notice and Orders to landfill owners or operators to bring landfills into compliance with the terms and conditions of their existing permits no later than August 1, 1992. Terms and conditions generally specify daily tonnage limits, height limits, and the types of solid waste a landfill can receive. However, since August 1, 1992, the board has continued this policy, and has allowed owners and operators of 56 landfills to violate their terms and conditions while seeking approval for revised permits from the LEAs and the board to address the violations.

By following this policy, the board will continue to allow operators to circumvent the law. For example, as part of the permit application process, a landfill owner or operator must provide evidence that it has complied with the California Environmental Quality Act, which requires the preparation of an environmental analysis and proper disclosure to decision makers and the public. However, because the 1990 policy does not require landfill owners or operators to file permit applications, they also do not prepare environmental analyses or seek comments from the public. Moreover, the board does not have a thorough understanding of whether its

1990 policy significantly affects the environment. In June 2000 it signed a two-year contract with a consultant to perform a study of the environmental impacts of landfills on air, water, and gas.

We recommended that the board discontinue the use of its 1990 enforcement policy. As previously stated in Finding #3, the board also needs to complete its study of the environmental impacts of landfills in the State.

Board Action: Corrective action taken.

The board reported that, during its June 2001 board meeting, it approved a modified policy that included limiting the policy's use to emergencies. Furthermore, at its August 2001 meeting, the board approved regulations to reflect the new policy, which the board submitted to the Office of Administrative Law for approval.

Finding #5: The board's oversight of the LEAs is weak.

The board's ineffective monitoring of landfill activity creates further environmental and health risks. The board did not monitor each landfill every 18 months, as state law requires, to ensure that the LEAs were adequately enforcing state minimum standards. Since 1995 the board was between 1 month and 4 years late in performing inspections at 132 of 176 active landfills. However, in the last year, it has made significant strides toward reducing the number of overdue inspections. The board also does not ensure that LEAs enforce landfill violations in a timely and effective manner. According to the board's database, as of August 31, 2000, LEAs had issued 64 active Notice and Orders to 47 landfill operators. Our analysis shows that for 43 of these orders, the operators have not met their deadlines and are overdue from 114 to 2,710 days. The board stated that its database may not be up-to-date because state law does not require LEAs to report on the final compliance deadlines or expiration dates of orders. Therefore, the board is in the process of revising its regulations to require them to do so.

Board staff told us that only one monetary penalty has been assessed in the past 10 years. By not assessing penalties against operators that fail to comply with orders, the board and LEAs allow them to continue to violate standards without consequences. Although the board believes that the statutory process for imposing civil penalties is cumbersome and that it often takes several years to resolve, it has not sought revisions to the statutes and modifications to regulations to address this issue.

Without appropriate board oversight, potential conflicts of interest between LEAs and landfill owners or operators cannot be mitigated and long-term violations can continue without correction. Conflicts of interest are possible because LEAs, which have enforcement responsibilities, are often part of the same local governments that receive revenues from owning and operating landfills.

We recommended that the board take the following actions:

- Continue to improve its performance in conducting landfill inspections every 18 months, as state law requires.
- Continue its efforts to modify regulations relating to tracking compliance with Notice and Orders.
- Ensure that LEAs require operators to comply with Notice and Orders by the date specified in the order, and issue penalties to those that do not comply.
- Seek legislation to streamline the current process for imposing civil penalties.

Board Action: Partial corrective action.

During the its July 2001 meeting, staff reported to the board that the current schedule for conducting landfill inspections would ensure 100 percent completion of all inspections within the 18-month time frame. In addition, the board adopted enforcement regulations that will require LEAs to report the status of their Notice and Orders to the board within 30 days of the compliance date included in the order. The Office of Administrative Law approved these regulations with an effective date of May 12, 2001. Staff also developed and implemented an internal tracking system for enforcement orders. Finally, the board stated that it directed staff to pursue legislative changes related to civil penalties.

Finding #6: Current laws and regulations allow landfills to remain open for long periods.

The board is allowing landfill operators to delay closure for extended periods. As a result, they are bypassing federal and state closure regulations established to address the fact that landfills not properly closed could threaten public health and the environment. Although state regulations require operators to submit final closure plans two years before completely ceasing operations, in 36 out of 289

instances, landfills had ceased operations before the board received the plans. Additionally, landfills are accepting only small amounts of waste, a process called "trickling waste," to delay final closure and post-closure maintenance. Our telephone survey of landfill operators for 38 landfills in the State revealed that operators for 9 of the landfills want to close down but are unable to do so because they lack the financial resources they need to pay closure costs.

Before regulatory changes were made in 1997, the board was responsible for coordinating the review and approval of closure plans. However, currently, neither the board nor any other entity serves as the coordinating agency, and the board has limited authority in directly ensuring that closure plans are submitted and implemented as required. Consequently, the board believes that the lack of coordination, consistency, and cooperation with other agencies on certain issues hinders effective closure activities. However, the board has taken no action either to change regulations to prevent LEAs from extending deadlines for closure plan submission indefinitely or to assume the role of coordinating agency.

We recommended that the board modify its regulations to prevent LEAs from indefinitely extending deadlines for submitting closure plans and to reestablish its role as the coordinating agency for the review and approval of closure plans. It should also seek legislation that will allow it to offer loans or grants to landfill operators in need of financial assistance to close landfills.

Board Action: Pending.

The board stated that it directed staff to amend regulations, as necessary, to reestablish the board as the coordinating agency for reviewing and approving closure plans, and to prohibit trickling waste in order to delay closure. In addition, the board directed staff to seek legislation that would allow the board to offer loans or grants to landfill operators in need of financial assistance when closing a landfill.

Finding #7: Local governments' diversion rates are questionable.

State law requires local governments to divert 25 percent of waste away from landfills by 1995 and 50 percent by 2000. However, the Legislature and the public may not be able to rely on the diversion rates local governments report to the board because those reported figures might not be accurate. The formula local governments use to calculate their diversion rates requires a reliable estimate of the

amount of solid waste generated in a base year. However, the amounts of solid waste generated have been inaccurate in the past because of erroneous estimates in the base-year numbers as well as a waste stream that constantly changes as population and economics vary. If local governments are reporting inaccurate diversion rates, the board cannot tell if they are complying with the law and cannot project California's future needs for landfills.

We recommended that the board modify its regulations to require local governments to revise their base-year figures at least every five years. Then, it should identify local governments that need to perform new base-year solid waste-generation studies and require them to do so.

Board Action: Partial corrective action taken.

The board stated that it does not have the statutory authority to require LEAs to revise their base-year figures every five years, but it believes it has the authority to require new studies if the existing measurement is found to be inaccurate. As a result, it has reviewed and approved approximately 80 revised base-year studies and it plans to review another 45 in the near future. However, we believe that the board has sufficient authority to require LEAs to revise their base-years periodically. Nevertheless, if the board believes it needs to seek legislative authorization, then it should do so.

Finding #8: Revisions to the board's diversion study guidelines can create inconsistencies in local governments' diversion rates.

Although the board did create a guide that contains various tools, strategies, and indicators for local governments to use in their efforts to meet the State's diversion goals, some suggestions outlined in the guide have received criticism. The act provides a broad definition of diversion to allow local governments flexibility to develop their own data for managing their programs and meeting diversion goals. In providing guidance to local governments, the board identified the types of materials they may count as diversion and have outlined some simple methods to quantify the amounts. When some board members and others expressed concern about the appropriateness of some of these methods, the board made revisions to its guide, but the result of these revisions can lead to inconsistent reporting of diversion data by local governments.

We recommended that the board should decide on the appropriate types of materials local governments can count as diversion and the methods to quantify those amounts. It should also seek concurrence from the Legislature as to whether its approach meets the original intent of the law.

Board Action: Partial corrective action taken.

The board indicated it believes the statutes currently identify the appropriate materials that locals may divert and it does not have the authority to make changes. However, the board did approve a diversion study guide during a meeting in April 2001 that will assist jurisdictions to properly identify their waste stream. The board also stated that it has reviewed the diversion rate measurement system as required by Senate Bill 2202, Statutes of 2000, and plans to present a draft report to the Legislature, which identifies potential improvements to the system. The board's agenda for its November 2001 meeting included consideration of the draft report for the board's approval. However, the board did not provide us with information indicating whether it ultimately approved the draft report during that meeting.

CALIFORNIA PUBLIC UTILITIES COMMISSION

Weaknesses in Its Contracting Process Have Resulted in Questionable Payments

REPORT NUMBER 99117.2, MARCH 2000

Audit Highlights . . .

Our review of the California Public Utilities Commission's (commission) contracting practices disclosed that:

- ☑ *The commission does not always adequately develop and manage its contracts, and as a result made more than $662,000 in questionable payments to its consultants.*
- ☑ *Despite the Bureau of State Audits' previous scrutiny of a problematic contract, the commission overpaid the consultant $12,500 and paid another $330,000 without adequately reviewing the contractor's invoices.*
- ☑ *The commission did not subject one of its contracts to the State's standard contracting process.*

The Joint Legislative Audit Committee requested that we review the California Public Utilities Commission's (commission) contracting practices. We determined that the commission does not adequately develop or manage some of its contracts and as a result has made more than $662,000 in questionable payments. We found the following:

Finding #1: The commission did not adequately develop some contracts.

For example, reasonably detailed budgets were not always included in the contract and some contracts were not subjected to competitive bidding. As a result, the commission did not ensure that the contracts clearly established what was expected from the contractors and provided the best value.

We recommended that the commission take these actions:

- Include reasonably detailed budgets and progress schedules in its contracts.
- Solicit competitive bids whenever possible.
- Establish minimum requirements for the level of detail that its consultants must include in their invoices.
- Require contract managers to review consultant invoices to ensure that only proper payments are made.

Commission Action: Corrective action taken.

The commission has developed a contracting manual to guide its staff in developing and managing contracts. The manual includes guidelines for establishing contracts and standard forms and procedures for monitoring and reviewing the work of consultants.

Finding #2: Because it did not require supporting documentation for consultants' invoices, the commission made at least $662,000 in questionable payments for fiscal year 1998–99, and the commission paid another $330,000 without adequately reviewing the consultants' invoices.

We recommended that the commission review its contracts and determine whether it had overpaid its consultants. The commission should attempt to recover any overpayments discovered.

Commission Action: Corrective action taken.

The commission reported that it reviewed each of its contracts, and where overpayments were identified, the commission requested repayment from the consultants. The commission reported that it recovered over $12,000 from one of the contractors we identified.

Finding #3: The commission did not subject one of its contracts to the State's standard contracting process.

The commission required several of its regulated utilities to enter into a contract on its behalf. As a result, the commission created an environment in which abuses could easily go undetected.

We recommended that the commission use the State's standard contract process for all contracts that it develops and manages.

Commission Action: Corrective action taken.

The commission told us that it will use the State's contracting process for all contracts it develops and manages.

CALIFORNIA SCIENCE CENTER

Investigations of Improper Activities by State Employees, Report I2000-1

Audit Highlights . . .

California Science Center public safety employees engaged in the following improper governmental activities:

- ☑ *Filed duplicate claims for overtime hours to receive $4,224 for 168 hours they did not work.*
- ☑ *Claimed $74,638 for 2,325 overtime hours even though they were not entitled to overtime compensation as managers.*
- ☑ *Claimed $730 for meals for which they were not entitled to receive reimbursement.*

Personnel department staff engaged in the following improper activities:

- ☑ *Allowed one managerial employee to accumulate 476 hours of compensatory time off even though managerial employees are not entitled to compensatory time.*
- ☑ *Failed to charge employees' leave balances for absences.*

ALLEGATION I990031, APRIL 2000

During the course of a 1999 audit of the California Science Center (Science Center), we found that seven public safety employees falsely claimed overtime pay totaling $2,324. We conducted a follow-up investigation and substantiated that at least 13 more public safety employees filed duplicate overtime claims and improper claims for meal reimbursement, and that managerial employees claimed overtime payments even though they were not entitled to overtime compensation. Specifically:

Finding #1: Public safety employees filed false claims for overtime and meals.

Between December 1997 and March 1999, at least 12 nonmanagerial employees in the Science Center's public safety department submitted duplicate overtime slips on 30 separate occasions and subsequently received $4,224 for overtime they had not worked. Eleven of these 12 nonmanagerial employees also improperly claimed and received $663 in payments for overtime meals.

In addition, four other employees, who because of their managerial status were not eligible for overtime, improperly claimed overtime payments. One of these managerial employees also claimed duplicate overtime payments and inappropriate claims for overtime meals. This employee was also allowed to improperly accumulate 782 hours of compensatory time off. In total, these four managerial employees received $74,706 in improper payments from July 1996 through March 1999, and the improperly accumulated compensatory time off cost the State more than $13,800.

Science Center Action: Partial corrective action taken.

The Science Center reported that:

- It has developed an automated tracking system that should eliminate duplicate processing of overtime slips and payments for public safety employees.
- It has obtained $1,326 in reimbursement for excess payment from five nonmanagerial employees and is still in the process of collecting another $2,475.
- It is still reviewing with counsel what action it should take with regard to the managerial employees.

Finding #2: The Science Center mismanaged its personnel function.

The Science Center had a grossly inadequate system of controls related to timekeeping, particularly overtime documentation. In fact, neither the personnel nor the accounting departments detected the aforementioned improper payments.

Further, the personnel department failed to accurately account for leave, thereby allowing the State to pay employees thousands of dollars more than they should have received. Specifically, although Science Center employees continued to accumulate leave, the department failed to charge leave balances for absences from September 1998 through April 1999. After we brought this to the Science Center's attention, its personnel department updated leave records in May 1999. However, because of a shortage of staff, the Science Center did not again update leave balances until December 1999.

Science Center Action: Corrective action taken.

The Science Center reported that it has hired new personnel office staff and is now updating leave balances on a regular basis.

CAL-CARD PROGRAM

It Has Merits, but It Has Not Reached Its Full Potential

REPORT NUMBER 2000-001.3, JULY 2000

Audit Highlights . . .

Our review of the State's use of its purchasing card (CAL-Card) program found that:

- ☑ *Personal use of the program is not widespread.*
- ☑ *High numbers of cardholders and a large volume of transactions have created unanticipated inefficiencies.*
- ☑ *CAL-Card sometimes inappropriately supplants other procurement methods.*
- ☑ *Departments that train their staff and enforce their policies have fewer problems with their CAL-Card program.*
- ☑ *Certain control features built into the CAL-Card program are not working as intended, which reduces their usefulness.*

The Department of General Services (General Services) created the State of California's purchasing card (CAL-Card) program in 1992 to streamline the process that state departments use to make small purchases. Under this program, state employees are issued credit cards to make work-related purchases. Between December 1998 and November 1999, CAL-Card purchases among state departments other than the California State University system totaled nearly $107 million. We reviewed the administration of the CAL-Card program at the seven state departments that used the program most heavily during this period. These seven departments are listed in the box on the following page. Although our review did not identify widespread personal abuses, we found 401 errors out of a total of 4,964 tests, an error rate of 8.1 percent. These errors included purchases with no detailed receipt or purchases specifically prohibited by departmental policies. We concluded that departments can more effectively use the program by integrating it into their overall procurement practices. In addition, some of the control features built into the CAL-Card program are not working as originally intended. Specifically, we found the following conditions:

Finding #1: Some departments may have more cardholders than needed.

Although the CAL-Card program has helped streamline the procurement process by providing departments with greater flexibility and a convenient mechanism for making purchases of less than $15,000, not all departments are using the CAL-Card program efficiently. Specifically, of the seven departments we visited, two—the Department of Parks and Recreation (Parks and Recreation) and the Department of Fish and Game—have issued cards to more than 40 percent of their employees, while another two, including the California Conservation Corps, have issued cards to more than 30 percent of their employees. We question whether this many employees should have procurement as one of their duties.

Finding #2: Small purchases are not always well planned.

About 4 percent of the transactions in our sample were for purchases that totaled less than $10 each and were made primarily for photo processing and single videotapes. The average transaction was less than $200 in 19 of the 31 largest departments (61 percent) participating in the CAL-Card program, and in 4 it was less than $100. Departments could improve the effectiveness of the CAL-Card program by planning and coordinating their purchases, especially very small purchases.

Finding #3: Growth in CAL-Card volume has increased administrative workload.

One of the benefits the CAL-Card program was to provide a reduction in more labor-intensive purchasing methods. However, of the seven departments we visited, at least two—Parks and Recreation and the Department of Transportation (Transportation)—have not experienced the expected decrease in these other methods. Additionally, due to the high volume of CAL-Card purchases, low staff levels at some departments, and the short time frame for payments to the sponsoring bank, some departments must redirect staff from other tasks to process the payments. Moreover, the high volume of CAL-Card transactions has proven a burden for cardholders, approving officials, and payment units when reconciling and processing CAL-Card statements. As a result, payments are sometimes delayed. We found that delays at various processing points have caused some departments to take longer to pay than the 45 days after the statement date that the CAL-Card contract requires. Planning and coordinating purchases, and limiting the number of cardholders might reduce the high volume of monthly transactions, which could lead to more prompt and efficient payment processing.

We reviewed the use of Cal-Cards at the following departments:

- ✓ Department of Transportation
- ✓ Department of General Services
- ✓ Department of Parks and Recreation
- ✓ Department of Forestry and Fire Protection
- ✓ Department of Fish and Game
- ✓ Employment Development Department
- ✓ California Conservation Corps

We recommended that departments determine the benefits they want to receive from the CAL-Card program, the level of resources they are willing to devote to managing and maintaining the program, and the benchmarks they will use to determine whether they have met their goals. Based on these assessments, the departments can determine how many cardholders and approving officials should participate in the program.

Department Action: Corrective action taken.

General Services has created an internal task force to review existing policies, procedures, and practices. To date, the task force has focused on updating existing CAL-Card policies and procedures. A draft version of the revised policies and procedures was scheduled to be finalized by August 31, 2001, and sent to the business services office for review. General Services has given its business services office the responsibility to oversee and monitor its CAL-Card program.

Transportation reports that its internal audit of its automated purchasing card system is almost complete. The audit includes a review of the methods used to determine the appropriate number of cardholders and approving officials. Transportation plans to implement recommendations from the audit once it is finalized.

The Resources Agency, which oversees four of the departments we audited—Parks and Recreation, the Department of Forestry and Fire Protection, the Department of Fish and Game, and the California Conservation Corps—reported that all of its departments have reviewed their CAL-Card usage. Departments using the CAL-Card have implemented changes in the areas of concern noted in the audit report or have a schedule outlined to complete implementation before October 1, 2001. Specifically, all departments have reviewed the number of cardholders and approving officials and have made changes where needed.

The Employment Development Department (Employment Development) indicated that it has completed an analysis of its existing CAL-Card program and has implemented corrective action where applicable.

Finding #4: CAL-Card sometimes supplants other more appropriate procurement methods.

Two departments—the California Conservation Corps and General Services—used the CAL-Card for purchases of more than $15,000 that would have been better handled by standard procurement methods. In addition, cardholders at Transportation and General Services had vendors split purchases to circumvent spending limits. We also found 61 purchases totaling $55,503 where cardholders used the CAL-Card for travel-related purchases for which the State has established other procurement methods. These purchases, such as lodging, meals, airfare, gasoline, and car rentals, are in direct violation of statewide CAL-Card guidelines.

We recommended that departments reemphasize to their cardholders and approving officials that the CAL-Card program has specific procedures and controls and is only one of several procurement methods available.

Department Action: Corrective action taken.

General Services noted that its internal task force is developing and implementing a comprehensive CAL-Card training program for cardholders and approving officials. The task force has decided that an interactive training course located on the department's intranet is the best approach for meeting this goal. A training course has been selected and will be implemented when the revised CAL-Card policies and procedures are finalized.

Transportation has completed comprehensive CAL-Card training in all districts for cardholders and approving officials. The training covered alternate procurement methods available as well as CAL-Card policies and procedures. During the 2001–02 fiscal year, Transportation plans to revise the CAL-Card Handbook and VISA Tips Guide and conduct follow-up training for cardholders and approving officials.

The Resources Agency reported that its departments have improved training requirements and programs. All cardholders must attend training classes and certify that they have completed such training before cards are issued. In addition, departments have instituted refresher training.

Employment Development indicated that it has an ongoing process to communicate the CAL-Card program's role in procurement through its CAL-Card manual and the initial training of cardholders. It also noted that it has developed an electronic mail database of all CAL-Card cardholders and approving officials to facilitate the communication of updated CAL-Card information.

Finding #5: Departments can improve controls over their CAL-Card programs.

Effective CAL-Card programs have four key components: policies, training, monitoring, and enforcement. Every department is responsible for training participants in the program, yet of the seven departments we tested, neither Transportation, the California Conservation Corps, nor General Services makes training

mandatory for cardholders and approving officials. Cardholders at these departments made prohibited purchases, circumvented CAL-Card policies, and failed to provide supporting documentation for their purchases more frequently than cardholders at the other four departments. In addition, poor implementation of the review process at some departments has weakened it as a control. We found that the initial review by the approving official is the most significant review a department performs. However, our testing indicated that reviews by approving officials do not always identify purchases of prohibited commodities and services. Moreover, the reviews do not always detect purchases that are not supported, that are missing required preapproval, or that violate other departmental policies.

We recommended that departments institute initial and ongoing training for cardholders and approving officials and develop monitoring systems that include reviews of policies specific to the CAL-Card program and department-specific elements, such as preapprovals. In addition, departments should develop and use enforcement policies that consist of warnings, reduction of credit limits, and removal of cardholders and approving officials that violate CAL-Card program policies.

Department Action: Corrective action taken.

General Services' new training course will include a module that emphasizes the compliance monitoring responsibilities of approving officials. Further, the business services office will establish procedures to ensure the ongoing monitoring of CAL-Card usage within the department. Also, General Services' audit section is including coverage of CAL-Card usage in its biennial review of the department's systems of internal control. General Services noted that it is continuing to take appropriate actions when misuse is identified, including the removal of cardholders and approving officials from the program.

Transportation has completed training for cardholders and approving officials. In addition, Transportation is continuing to address post-payment monitoring in the CAL-Card program and establishing post-payment procedures. When the internal audit of its automated purchasing card system is finalized, Transportation plans to implement the audit recommendations.

The Resources Agency reported that its departments have strengthened their monitoring and enforcement policies. Where appropriate, departments have assigned additional monitoring staff. Departments have also strengthened consequences for inappropriate use of the CAL-Card and, in some instances, employees have been counseled for incorrect use of the card.

Employment Development noted that it has an ongoing process that requires training of all new cardholders and approving officials. Additionally, its CAL-Card staff is currently merging files into a new database that will allow more flexibility in tracking CAL-Card information. In an effort to strengthen the approving process, Employment Development has identified and trained alternate approving officials. In the future, new card requests will require that an alternate be identified at the time cards are requested. The cardholder, approving official, and alternate will be scheduled for training at the same time.

Finding #6: Control features provided by the bank are not working as intended.

Two primary controls that the sponsoring bank installed in the program—dollar limits and merchant category restrictions—are meant to prevent the misuse of the CAL-Card. However, dollar limits can be circumvented, and the use of merchant category restrictions actually limits the ability of cardholders to make legitimate purchases. We found three instances in our testing where cardholders were able to circumvent either the single purchase limit or the 30-day purchase limit. Further, because of the way the bank has grouped vendor types into merchant codes, two departments have found that using these codes hampers their normal operations and have lifted all vendor restrictions. At least two merchant codes include such a wide variety of vendor types that their effectiveness as a control is diminished. For example, one merchant code includes 82 separate vendor types that encompass stores selling computer equipment, hardware, office supplies, jewelry, flowers, and cigars. Although many of the vendors in this code provide goods that are appropriately obtained with the CAL-Card, others are much less likely to sell items that staff can legitimately purchase. However, because one merchant code includes all these vendors, departments cannot block the inappropriate vendors without also blocking the appropriate ones.

We recommended that General Services, as the State's CAL-Card coordinating agency, negotiate with the bank for revised groupings of vendor types into merchant codes to allow departments to more effectively block inappropriate vendors.

Department Action: Partial corrective action taken.

General Services recognizes the need for the capability to restrict uses of the CAL-Card through the merchant coding system and included this in the request for proposals issued in June 2000 for the new contract. The existing contractor was the successful competitor. However, the contractor did not propose significant improvements to the merchant coding system because of limitations in what could be reasonably provided without significant cost to the State.

CALIFORNIA'S WILDLIFE HABITAT AND ECOSYSTEM

The State Needs to Improve Its Land Acquisition Planning and Oversight

REPORT NUMBER 2000-101, JUNE 2000

Audit Highlights . . .

Although various entities acquire land for ecosystem restoration and wildlife habitat preservation, the State does not have a comprehensive land use policy that provides a common vision of goals and objectives that these entities can follow.

- ☑ *The two state departments that are acquiring the most land for these purposes—the Department of Fish and Game and the Department of Parks and Recreation—have not performed key tasks for managing these properties. Specifically, they:*
- ☑ *Have not prepared management plans for at least one-third of their properties.*
- ☑ *Use outdated management plans for many properties.*
- ☑ *Inadequately manage some land because they have not achieved certain management objectives or undertaken specific projects.*
- ☑ *Insufficiently document their management efforts.*

At the request of the Joint Legislative Audit Committee, we reviewed the state entities that acquire land for ecosystem restoration and wildlife habitat preservation, both within and independent of the CALFED Bay-Delta Program (Calfed). However, Calfed does not acquire land for these purposes. State entities that do acquire land for environmental purposes include the Department of Fish and Game (Fish and Game) and the Department of Parks and Recreation (DPR). Each of the many entities that acquire land, including state and federal agencies and private and nonprofit organizations, has a process for selecting and acquiring land to accomplish its individual mission and objectives, but a uniform statewide process for acquiring land does not exist. Our review revealed the following:

Finding #1: The State does not have an overall plan for coordinating acquisition of land for wildlife habitat preservation and ecosystem restoration.

As early as 1970, the Legislature directed the Governor's Office of Planning and Research (OPR) to oversee land use planning and to prepare a statewide environmental goals and policies report. However, the OPR has not developed a comprehensive land use policy, and it has not issued a new or updated goals and policies report since 1978, despite state law requiring that such a report be produced every four years. Without a statewide land use policy, the state entities have no clear central vision to ensure that their decisions for acquiring land are compatible with the State's goals and objectives for preserving and restoring the environment.

To ensure that it fulfills its responsibility for developing a statewide land use policy, we recommended that the OPR:

- Develop and implement a comprehensive approach for addressing statewide land use planning. Inherent in this mission should be the development of an overall plan for the State to acquire land for ecosystem restoration and wildlife habitat preservation.

- Identify resources it can use from projects and studies already performed by other entities and consider this data when developing its approach.

- Project staffing and resource requirements it needs to fulfill its mandates, and seek additional staff and resources as necessary.

- Update the statewide environmental goals and policies report and continue to update this report every four years as state law dictates.

OPR Action: Partial corrective action taken.

The OPR is in the process of developing a comprehensive interagency approach to future state land use issues, as part of a new environmental goals and policies report. Although this report will include much broader issues than wildlife habitat and restoration alone, plans for acquiring and managing state land for ecosystem restoration and wildlife habitat preservation will be addressed.

The OPR is in the process of developing an inventory of programs administered by state agencies and will evaluate each agency on its mission, goals, and programs. The OPR also has identified 14 state functional plans that directly relate to its environmental goals and policies report and plans to participate in the development of these plans. Thus far, the OPR is participating in the development of the State's transportation and water plans. In addition, the OPR developed the California Planning Information Network (CalPIN), a web-based tool to gather information from local government planning agencies regarding local land use issues and trends.

In August and September 2000, the OPR hired two additional land use planners, bringing the total number of planners to four. In January 2001, the OPR also hired a director for the rural policy task force program. In addition, the OPR reported that it added new staff to its Policy and Research Unit in February 2001. The OPR reports that it will also try to persuade other state agencies to allocate resources for a comprehensive effort.

The OPR reports that it has made important progress toward the development of a new environmental goals and policy report. However, it identified major impediments to the timely, successful completion of the report such as the lack of staffing; cost and time of collecting and analyzing data; lack of availability and assistance from other state agency staff; other state priorities (i.e., energy); and the State's overall fiscal constraints.

Finding #2: The State does not have a comprehensive inventory system to facilitate statewide land use planning.

Many state entities maintain inventories of land they own. But the State does not have a comprehensive system to facilitate statewide land use planning by readily identifying land acquired for specific purposes, including ecosystem restoration and wildlife habitat preservation.

We recommended that the OPR work with other state entities to ensure that a composite inventory of land the State owns exists and that the inventory includes information on the purpose for which each property was acquired.

OPR Action: Partial corrective action taken.

The OPR reports that it has worked diligently with the Department of General Services (DGS) to expand the Statewide Property Inventory (SPI) database to make it a more useful tool for the identification and management of state properties. Also, in response to the current energy situation, the OPR developed a State Owned Land Energy Review Task Force to assist in the identification of State lands that could be made available for peaker generation facilities. This information was input into the SPI. Further, on OPR's behalf, the California State University, Sacramento completed a preliminary study, An Inventory Study of the State of California's Land Holdings, in May 2001.

Finding #3: Neither Fish and Game nor the DPR prepare a management plan for each property they acquire and they do not regularly update existing management plans.

Fish and Game and the DPR have not completed management plans for 318 (50 percent) of their 632 properties and parks. Management plans, the essential first step of proper land management, identify the natural resources present and the goals or strategies for maintaining each property for the purpose it was intended. In addition, although Fish and Game requires a review of its land

management plans at least every 5 years, 128 (86 percent) of its 149 completed plans were more than five years old. Similarly, almost half of the DPR's 165 existing general plans had not been updated for more than 15 years and 51 were more than 20 years old. By not updating these plans, the departments cannot ensure that they are complying with relevant environmental laws or considering other relevant factors relating to the proper use of the land.

We recommended that Fish and Game and DPR prepare final plans for all of their properties and parks that describe goals and strategies for managing the land. We also recommended that Fish and Game and DPR update their older land management or general plans.

Department Action: Partial corrective action taken.

According to Fish and Game, updating and completing management plans for all existing properties is an ongoing high-priority task for the department's Lands and Facilities Branch. Fish and Game is developing a database to catalog management activities on its properties and produce standardized data for management plans. In addition, another database used to extract and enter baseline biological data into the plans, is almost complete. Fish and Game expects that these two databases will expedite plan development. Fish and Game reported that 9 management plans are currently being developed and staff are scheduled to revise 59 plans by the end of fiscal year 2003–04.

The DPR has begun the management plan development and update process and has hired additional staff.

Finding #4: Fish and Game and DPR did not adequately manage some land.

For three of four properties managed by Fish and Game and three of the six DPR restoration projects we reviewed, the departments did not meet certain objectives. Consistent and thorough management of acquired land is essential for ongoing benefits. Moreover, delays in restoring or maintaining land may also result in additional problems. In the past, insufficient funding has hampered the departments' management efforts. However, Fish and Game and the DPR have recently received additional funds for certain land management activities.

We recommended that Fish and Game and the DPR perform restoration, rehabilitation, and improvement projects, as well as periodic inspections of all land, in accordance with their land management or general plans. In addition, Fish and Game and the DPR should continue to request additional funding to ensure that land acquired for ecosystem restoration and wildlife habitat preservation is kept in its desired condition.

We also recommended that the Legislature consider establishing a mechanism in future bond acts involving land acquisitions that sets aside a portion of the proceeds for major maintenance projects. Moreover, the Legislature should consider establishing a mechanism to ensure that ongoing management of land acquired with the bond money is funded; for example it could create a designated revenue stream or require the departments to establish a plan for demonstrating how those ongoing costs will be met before acquiring the land.

Department Action: Partial corrective action taken.

Fish and Game did not specifically address our recommendation to perform restoration, rehabilitation, and improvement projects, as well as periodic inspections of all land in its one-year response.

The DPR has hired additional staff to help manage park improvement projects. In addition, the DPR has developed procedures for conducting periodic, routine inspections of natural resource conditions. The DPR has received significant funding to perform restoration, rehabilitation, and improvement projects. The DPR believes that this funding will have a positive impact on its ability to increase ongoing natural resource inspections, monitoring, and corrective actions.

Legislative Action: Unknown.

To ensure that ongoing management of land acquired with bond money is funded, Assembly Bill 1414 proposes changes that will require the Resources Agency, until January 1, 2010, to prepare an annual report summarizing expenditures on the California Clean Water, Safe Neighborhood Parks, and Coastal Protection Bond Act of 2002, if that act is enacted by the Legislature during the 2001–02 Regular Session of the Legislature.

Finding #5: Fish and Game and the DPR maintain insufficient documentation of their management efforts.

Although Fish and Game developed a standard monitoring report for inspecting progress, the report does not capture information on whether staff are meeting the goals and objectives of land management plans. During our audit, Fish and Game told us that it recognizes that its land managers use varying methods and it plans to develop a statewide reporting format to foster greater consistency. Until it completes this tool and incorporates a component that addresses whether its management activities meet the goals and objectives of land management plans, it cannot ensure that sufficient documentation exists to verify its land management activities. Similarly, the DPR does not have uniform standards for monitoring its parks. The DPR was aware of this problem and had prepared a draft natural resource inventory monitoring and assessment guideline. Without standard procedures, park district staff cannot track and maintain information in a uniform manner, and the DPR cannot properly oversee its land management efforts.

We recommended that Fish and Game should develop and implement procedures for documenting its land management activities that address goals and objectives of its land management plans. We also recommended that the DPR should complete and implement its draft guidelines for standard, uniform monitoring procedures.

Department Action: Partial corrective action taken.

Fish and Game is developing a database to catalog management activities on its lands and produce standardized data for management plans.

The DPR is collecting system-wide monitoring information on the status of key resource factors on all State Park Systems units.

STATE BAR OF CALIFORNIA

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

Audit Highlights . . .

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

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

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

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

REPORT NUMBER 99030, APRIL 2001

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

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

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

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

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

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

State Bar Action: Pending.

By the end of the first quarter of 2002, the State Bar plans to update the cost model with labor costs effective January 1, 2002. In addition, the State Bar reported that it has had preliminary discussions with legislators and legislative staff about possible participation in the Offset Program.

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

The State Bar has improved its accounting for the voluntary and mandatory fees it charges members and for the programs that the fees support. As a result, it can better ensure that mandatory fees are reasonable and that they do not fund voluntary programs. Also, the State Bar has willingly determined the amount of mandatory fees it needs to perform its required functions. As a result, both the State Bar and its members have greater assurance that members who choose to pay only the mandatory fees do not bear the costs of voluntary programs. In addition, the State Bar is better able to justify the level of fees it annually charges its members.

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

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

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

State Bar Action: Partial corrective action taken.

The State Bar plans to update its procurement manual to provide additional clarification on its purchasing card program and contracting policies and expects to conduct mandatory training sessions in the first quarter of 2002. In addition, the State Bar reported that accounting staff check for receipts for purchases exceeding $25 as part of the account payable review process. Also, staff check to see that any discretionary spending is charged to the business expense account. Finally, at the beginning of the new budget year, the State Bar plans to issue an administrative advisory stating that no business expenses may be incurred beyond the account budget.

INFORMATION TECHNOLOGY

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

REPORT NUMBER 2000-118, JUNE 2001

Audit Highlights . . .

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

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

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

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

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

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

DOIT Action: Partial corrective action taken.

DOIT has established an advisory workgroup of chief information officers to develop a statewide IT plan. In December 2001, DOIT entered into a contract with a vendor to implement a phased approach for the development of the statewide IT plan. Also in December 2001, DOIT and the advisory workgroup finalized the group's project charter, which established a project schedule that indicated that DOIT would publish the final statewide IT plan on June 30, 2002. DOIT plans to use the IT strategic plans of state departments in the creation of statewide IT plan initiatives. DOIT expects that the advisory workgroup will work with the agency information officers of state departments to identify and validate cross-cutting statewide initiatives. DOIT plans to work with the chief information officers, the department information officers, and the Department of Finance to ensure that the statewide IT plan establishes priorities and measurable objectives.

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

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

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

DOIT Action: Partial corrective action taken.

In response to our concerns, DOIT developed a checklist to evaluate departments' IT plans against DOIT's requirements, best practices, and state policy. Using this checklist, DOIT indicates that it completed the review of 46 department IT plans

and informed 28 other departments that they had not submitted an IT plan or certification that their IT plans had not changed. Sometime during 2002, DOIT intends to update the State Administrative Manual to reflect the revised IT plan guidelines.

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

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

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

DOIT Action: Partial corrective action taken.

DOIT hired a consultant to review existing IT policies and the consultant recommended that DOIT consolidate sources of policy and remove outdated polices, and revise and restructure the State Administrative Manual and DOIT's Statewide Information Management Manual. To implement the consultant's recommendations, DOIT plans to prioritize changes to the manuals and develop a web-enabled process to allow departments access to all existing policies and standards. DOIT also implemented a review process to allow stakeholder departments to comment on proposed policies and standards before they are published. In regards to clarifying the alternative procurement process, DOIT collaborated with the Department of General Services to assess the alternative procurement process and believes that state policy guidance on this process will be updated by April 2002.

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

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

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

DOIT Action: Corrective action taken.

DOIT indicates that it updated the project approval process in June 2001 and created a checklist and project summary form to ensure that all projects meet state requirements and that its decision process is documented. DOIT states that it reviewed 112 proposed projects using its new process since then. In regards to assessing the risk of proposed IT projects, DOIT now requires that departments complete risk assessments at the conceptual phase and at key milestones for all projects regardless of the procurement process used. To document its oversight activities with departments, DOIT requires its staff to use standard communication logs, meeting agendas, and meeting summaries, and has implemented a standard process for maintaining project approval and oversight documents. DOIT has several plans to further enhance its review and processes, including an online project submission and approval process that it expects to implement in March 2002.

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

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

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

DOIT should improve its project oversight by requiring that project progress reports include the project's monthly actual costs and revised estimates of total projected costs compared with the budget, and actual and revised projected completion dates for project phases compared with the original schedule. In addition, DOIT should ensure that analysts sufficiently review and document their oversight of projects and track the receipt of required reports. It should also hold departments accountable for the benefits expected and incorporate lessons learned from their IT project development by ensuring that they submit post-implementation evaluation reports and then review these reports.

DOIT Action: Partial corrective action taken.

DOIT reports taking several actions to improve its oversight of IT projects under development. For instance, it modified the monthly progress report to include additional expenditure and schedule information, but did not modify the report to include the project's monthly actual costs and revised estimates of total projected costs compared with the budget, or the revised projected completion dates compared with the original schedule. DOIT also developed a metrics-based oversight checklist to assist its staff in assessing project health. For projects that have significant issues, DOIT states that its director and other executive staff meet with department staff to discuss DOIT's expected corrective actions. DOIT indicates that it currently maintains completed documentation on all reportable projects and is using a database to track and monitor the receipt of required project documents.

During 2002, if funding is available, DOIT expects to implement a web-enabled tool to display health of projects and make this information available to the Legislature and departments. Finally, DOIT reports that in December 2001 it enhanced its process for reviewing post-implementation evaluation reports and updated its review checklist to include state requirements and industry best practices. DOIT indicates that it has now reviewed all 66 post-implementation evaluation reports that it received between January 1999 and October 2001.

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

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

State lacks assurance that it can identify overlapping or redundant IT efforts, and departments do not benefit from each others' knowledge of technology and development approaches.

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

DOIT Action: Partial corrective action taken.

DOIT reports that its advisory workgroups of chief information officers meet regularly to promote coordination of IT projects to avoid redundancies between departments and to identify IT strategies and issues with statewide impact. DOIT has also established a biweekly council of department information officers and advisory workgroup chairpersons to promote and improve communication between state entities. DOIT believes that its web-enabled project submittal process, to be implemented in 2002 if funding is available, will allow its managers to have an increased awareness of department needs and be able to share this information with other state agencies.

To complete its project inventory, in December 2001, DOIT notified five departments that had not responded to its November 2001 IT project survey that further failure to respond may result in the department's loss of its IT project delegation authority. In December 2001, DOIT notified all departments of the requirement to annually update their IT project information by January 31, 2002. However, we recommended that DOIT update its inventory as it receives project data, rather than annually, and we recommended that DOIT proactively validate the accuracy of department data, rather than relying upon departments to annually review this data. While DOIT indicates in other areas of its response that it expects to implement a web-enabled tool to display project health data, and make this data available to the Legislature and departments, it does not indicate if this tool contains all the data that would be useful for coordination purposes.

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

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

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

DOIT Action: Partial corrective action taken.

DOIT reports that, through discussions with the Legislature, it determined that accessibility, security, and infrastructure standards needed to be addressed first. In August and September 2001, DOIT posted proposed standards in these areas on its web page for review and comment by a variety of stakeholders, including chief information officers, the Department of Finance, and others. DOIT also had the Department of General Services update the State Administrative Manual to reflect the need for departments to follow established statewide standards. DOIT plans to continue to work with the Department of Finance to finalize these standards and plans to post them on their Web site by the end of February 2002. DOIT will continue to develop additional standards based on the priorities from the two state-mandated advisory councils.

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

DOIT has not consistently used two state-mandated advisory councils established to provide advice on its activities. One required council—the private commission—should consist of IT practitioners

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

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

DOIT Action: Corrective action taken.

DOIT reports that it has been meeting with the private commission monthly and meets twice a month with the public committee. DOIT states that it currently maintains a written record of all findings and recommendations made by the private commission and the public committee.

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

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

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

DOIT Action: Partial corrective action taken.

DOIT reports that its has developed a preliminary list of initiatives with timelines and goals for implementation over the next three fiscal years, but is adjusting it as a result of proposed budget reductions and new mandated responsibilities. DOIT plans to use its annual report and budget to communicate with the Legislature its priorities and resource requirements and to notify the Legislature of any changes in the IT environment that might prompt adjustment to DOIT's priorities and resources. DOIT plans to communicate with the Legislature by correspondence and meetings when it cannot meet deadlines or believes state priorities may need to be revisited.

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

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

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

DOIT Action: Partial corrective action taken.

In December 2001, DOIT posted the edited version of its draft internal strategic plan on its website. DOIT has developed a business plan to identify initiatives and timelines for meeting the goals of its internal strategic plan. In February 2002, DOIT plans to further refine its business plan, which will include dates and priorities, to reflect new fiscal constraints and initiatives.

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

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

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

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

- Ensure that the vendor provides sufficient staff with the necessary training and experience.

- Use an effective project management plan before beginning to develop each project so it can monitor the progress of the projects.

- Ensure that it establishes and uses a process to control and monitor project scope changes that requires changes be adequately reviewed before they are made.

- Correct the IT security weaknesses we identified.

Employment Development Department Action: Partial corrective action taken.

The Employment Development Department reports that based on the lessons learned from the TEAM project and our recommendations, it is updating its project management practices. Further, to ensure that vendors provide sufficient and appropriate staff on IT projects, it has developed standard contract provisions related to staffing and is developing a checklist to use during contract negotiations. While the Employment Development Department reports that it is updating security policies, procedures, and guidelines to address the security weaknesses we identified, the upgrading of its security systems will not begin until July 2002.

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

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

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

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

Franchise Tax Board Action: Corrective action taken.

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

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

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

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

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

may have made it difficult for the IV&V consultant to objectively oversee the performance of the project manager. These problems have likely contributed to the project's cost increase and delay.

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

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

Health Services Action: Partial corrective action taken.

Health Services indicates that it established a separate unit to oversee IT project management and planning. This unit's oversight responsibilities will also include vendor selection and contracts process for IT projects. To assist Health Services in developing project management procedures, it hired a consultant to recommend the structure for a project management office. The consultant's recommendations are expected in spring 2002. In addition, Health Services reports that its legal and IT units are working together to ensure that contracts are deliverable-based and that payment is made only upon successful completion of project deliverables. Further, it is developing contract language and processes to ensure that an IV&V contractor and its consultants can only provide IV&V services to a project. Finally, Health Services indicates that it is working with the Health and Human Services Data Center to ensure that its security policies and procedures are adequate and appropriate.

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

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

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

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

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

- Develop a problem statement for each IT project that adequately describes the problem the project is intended to solve with quantifiable goals, and a supportable business case for each project that justifies its funding.

- Develop an effective project management plan before beginning to develop each project so it can monitor the progress of the project.

- Allow vendors to propose solutions and the technical specifications for its large and complex IT projects.

- Ensure that testing is completed at appropriate phases to identify and resolve problems before moving ahead.

- Ensure that it uses sound management practices during the development of each project, such as assigning qualified individuals with appropriate experience and training to manage the project, documenting key discussions and decisions, and monitoring progress through periodic reports.

- Use IV&V consultants on complex IT projects.

Caltrans Action: Partial corrective action taken.

To improve and standardize its project management practices, Caltrans reports establishing a separate project management division. With the assistance of a consultant, the new division is developing and standardizing Caltrans' project management procedures, including how it initiates projects. In addition, during the summer of 2001, Caltrans indicates that approximately 300 staff received training on its project management procedures and 35 staff received detailed project management training based on the Project Management Book of Knowledge. Further, Caltrans states that it intends to allow vendors to propose solutions and the technical specifications for its large and complex projects. In regards to ensuring that testing of IT projects is completed at appropriate phases, Caltrans states that the oversight of IV&V consultants and its risk management office will provide this assurance, but that budget cuts prevent it from forming quality assurance and IT architecture units that would also review the testing of IT projects. Caltrans states that it is now using IV&V consultants on five of its IT projects, including ATCAS, and indicates that it will use IV&V consultants on other projects as it deems appropriate.

THE STATE'S REAL PROPERTY ASSETS

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

REPORT NUMBER 2000-117, JANUARY 2001

Audit Highlights . . .

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

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

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

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

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

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

General Services Action: Corrective action taken.

General Services stated that when turnover occurs, prompt actions are taken to fill vacancies in the unit. When necessary, General Services stated it also redirects staff to ensure adequate coverage in the unit. Finally, to ensure prompt processing, properties declared surplus in the future will be assigned to staff immediately after the surplus bill is signed into law rather than waiting until the law takes effect on January 1st.

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

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

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

Caltrans Action: Partial corrective action taken.

Caltrans expected to complete a full reconciliation of ELMS and its Right of Way Property Management System (RWPS) by October 1, 2001. In addition, Caltrans reported that it made significant progress in correcting errors and omissions in ELMS and in providing staff training to ensure ELMS entries are timely and accurate. Caltrans also reported several actions it has taken to ensure prompt disposal of properties. These actions include: ensuring districts' excess lands sections are appropriately staffed, using retired annuitants when necessary, pursuing a

consultant contract for surveying services, and issuing guidelines for local agency involvement in right of way acquisition and project delivery.

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

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

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

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

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

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

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

Legislative Action: Unknown.

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

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

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

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

- Make certain that the various units at district offices adequately participate in and work together to administer effectively the annual reviews of real property retention.

- Ensure that district offices follow the retention-review guidelines and maintain asset managers to provide year-round coordination of the management of surplus property and to improve the quality of annual retention review efforts.

- Revise the retention-review guidelines so that they include the following elements:

  - Specific criteria for districts to evaluate the buildings and facilities listed in the Asset Management Inventory.

  - Procedures for ensuring that the ongoing monitoring of surplus property withheld from disposal is sufficient and appropriate.

  - Steps for reviewing noninventory property to ensure that the department needs the property for future highway projects.

Caltrans Action: Partial corrective action taken.

Caltrans expected to deliver by October 1, 2001, a revised Deputy Directive (directive), which comprehensively addresses the department's facility planning and surplus property management practices, and a new Asset Management Business Plan that reflects the directive. The department was also revising its Real Property Retention Review (RPRR) guidelines to update its procedure for evaluating and identifying surplus property. The department also expected these changes to be completed by October 1, 2001. Finally, the department reported that it revised its RPRR to include minimum review frequencies for properties conditionally retained or for which disposal is recommended, a review of noninventory properties, and a preliminary review of properties available for sale.

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

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

- Working with state agencies to identify the property characteristics the inventory must contain to serve as an effective property management tool and seek changes to the law if necessary.

- Developing changes to methods for operating the inventory system to promote efficiency. For example, new methods could give agencies the ability to enter required property information into the system and to verify the accuracy of the inventory through real-time access to the inventory's data.

- Cooperating with land-owning state agencies to provide standard property identification elements that will facilitate the reconciliation of the inventory systems maintained by the agencies.

- Seeking to change the funding mechanism for the inventory to eliminate the current disincentive for state agencies to provide information to the system.

General Services Action: Partial corrective action taken.

General Services stated that in April 2001, it sent a memorandum to all state agencies asking them to identify any additional information that they would like to see included in the inventory. However, General Services did not provide details on the results from its request. General Services also stated that on July 20, 2001, it updated its intranet Web site to allow users to run a number of inventory reports within specified parameters. However, General Services has not deployed inventory information to the internet because of safety and security concerns. In addition, General Services does not plan to examine until early 2002 the feasibility of allowing other agencies to have data entry capabilities for the inventory because it has determined this project will have significant costs and complexity. General Services reported that it plans to communicate with agencies on how they can cross-reference with their own property identification numbering schemes for reconciliation purposes. Finally, General Services determined that there is no fair or practical alternative to the current method for funding the inventory.

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

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

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

General Services Action: Pending.

The management of Surplus Sales and the Asset Planning and Enhancement Branch is acting to improve the accuracy and completeness of the surplus property database. General Services expected to complete these improvements by January 30, 2002.

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

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

To improve the value of reports to the Legislature regarding its surplus property inventory, we recommended that General Services submit these reports promptly and consider including additional detailed information on the status of surplus property. In these reports, General Services should also describe the weaknesses in the State's real property systems and include suggestions to improve the State's ability to identify and dispose of surplus property.

General Services Action: Partial corrective action taken.

General Services agreed to submit its report on surplus property to the Legislature in a more timely manner. Although its goal was to submit this year's report by the end of February 2001, it did not submit this report to the Legislature until May 23, 2001, due to other operating priorities.

General Services also stated that the report now includes more detailed information on the status of surplus property. However, it did not address whether the report contains information related to program weaknesses and suggestions for improvement.

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

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

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

Caltrans Action: Partial corrective action taken.

As mentioned earlier, Caltrans expected to complete a full reconciliation of is ELMS and RWPS by October 1, 2001. Caltrans also stated that it made significant progress in correcting errors and omissions in ELMS and in providing staff training to ensure ELMS entries are timely and accurate. Further, Caltrans reported that it delivered an accurate and timely report with the status of its real property holdings to General Services on June 29, 2001, and that its development of an Asset Management System is on schedule for implementation by July 2002.

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

General Services does not always enforce the requirements of the program, such as executing lease agreements and collecting rent for building space occupied by child care providers. In addition to

losing revenue by not collecting rent, General Services may be exposing the State to unnecessary liability because it has not always executed required building space leases.

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

- Improving its administrative controls over leases for child care facilities to ensure that required leases are in place and that nonprofit corporations established by employees to provide child care facilities meet all the terms and conditions of the leases, such as the nonprofits' making agreed-upon payments for the leased spaces.

- Developing and implementing a system to communicate among General Services' relevant units, such as those involved in building design, child care facility review, leasing, and accounting, to ensure that all affected units are aware of child care facilities under General Services' jurisdiction.

- Conducting the required initial reviews to determine whether state employees need child care facilities and, after the facilities have operated for five years, comparing state employees' continuing need for the facility to the State's need for additional office space.

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

General Services Action: Pending.

General Services completed an initial review to identify actions needed to ensure fully operational and viable child care facilities. However, the review raised concerns about the viability of these centers statewide. As a result, General Services chartered another team to develop an action plan and leasing policy that will assure the viability of child care centers in state-owned office buildings. This action plan was due on September 1, 2001.

With regard to assessing the initial and continuing need for child care facilities, General Services stated that its existing policies and practices provide for the conduct of initial child care need studies as required by statute. General Services reports that it completed 10 initial review studies between November 30, 1999, and July 30, 2001. In addition, General Services developed an assessment form for performing needs assessments of the child care centers that have been in operation for five years. General Services reported that it completed five assessments between March 30, 2001, and July 30, 2001, and that three more assessments were underway.

Finally, General Services stated that the policy the charter team develops will ensure rent is charged for child care facilities as provided by law, that rents are fair and reasonable, and, at a minimum, recovers the State's administrative costs.

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

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

General Services Action: Partial corrective action taken.

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

BLACKOUT PREPAREDNESS

The Office of Emergency Services and the California National Guard Each Have Weaknesses in Their Blackout Preparations

REPORT NUMBER 2001-111.1, SEPTEMBER 2001

The Joint Legislative Audit Committee asked us to determine whether the California National Guard (CNG) has a plan to deal with blackouts resulting from the State's energy shortage. Our review also includes an evaluation of the Office of Emergency Services' (OES) plan since it is primarily responsible for assuring the State's readiness to respond to and recover from man-made emergencies such as electrical blackouts. Specifically, we found:

Finding #1: The OES has an alternative power source during a blackout but other concerns about its preparedness exist.

In the event of a blackout, the OES has a generator at its headquarters as an alternative power source. The OES headquarters houses its State Operations Center, which is one of the key locations it uses to receive and process local government's requests for assistance. According to the OES, it runs and inspects the generator on a regular basis, which is a reasonable precautionary step to ensure that this critical facility will have power. However, the OES may have other weaknesses that can affect its blackout preparedness.

In March 2001 the OES distributed to its staff an Energy Shortage Response Matrix (response matrix), which provides background and insight into potential public safety impacts, state actions to date, and its policy relating to energy responses. For example, the OES found that an evaluation of its plans for transferring responsibilities for critical functions to unaffected units and relocating staff to an alternative work site was necessary to refine its Business Continuity Plan (continuity plan). It also recognized the need to evaluate its continuity plan and emergency procedures to ensure back-up systems are operating and whether it could handle a natural disaster during an energy crisis. The OES asserts that it has taken steps to address some of the activities found in the matrix, but we are uncertain if or how it has resolved a few key concerns it raised in its response matrix.

To strengthen its blackout preparedness, the OES should, at a minimum, review and document its efforts to ensure that its relocation and transfer plan, business continuity plan, and emergency procedures address sufficiently the State's energy situation.

➲ ***Department Action: None.***

The OES 60-day response to our recommendations was simply a reiteration of its original audit response letter. The OES states that weaknesses in blackout-specific preparedness activities were already addressed by pre-existing, all-hazard emergency management practices. We disagree. The OES prepared a response matrix in March 2001 and for certain potential public safety impacts, the OES identified additional steps it should take to minimize disruptions to its operations. For example, it recognized the need to evaluate whether it could handle a natural disaster during an energy crisis. Because the OES identified these concerns itself, it seems clear that they were not already addressed by pre-existing practices as the OES is now claiming.

Further, we disagree with OES' belief that its continuity plan and Relocation and Transfer Plan can address a potential blackout situation. In June 2001 the OES identified concerns with its continuity plan and Relocation and Transfer Plan. Moreover, since the OES did not provide us with any evidence such as changes it made or changes that may be pending during the audit or as part of its most recent response, we question whether it has taken the necessary steps to resolve its concerns about its own preparedness.

Finding #2: The OES has taken steps to inform the emergency response community and others about blackouts but some efforts could be stronger.

In addition to preparing itself for blackouts, the OES has worked with the emergency response community to share information about the energy crisis and assist them in planning for blackouts. The OES has also implemented a notification process that provides for a series of alerts prior to a potential blackout. However, the OES lacks a way to evaluate its effectiveness and therefore, may overlook necessary changes or improvements. Finally, the OES developed a guide for local governments in planning for power outages. Although this document addresses many critical planning

issues, the OES may not be able to assist local governments because it has not designated staff to respond to inquiries nor has it trained its staff on how to use the planning document.

We recommended that the OES establish a method to periodically evaluate its notification process, which includes documenting the results of its evaluations and following up with participants to ensure that all necessary changes are made. In addition, the OES should assign specific staff to be responsible for responding to local governments' inquiries about its power outage planning guide. It should also train these staff on how to use the guide and advise local governments on their planning efforts.

➲ ***Department Action: None.***

The OES 60-day response to our recommendations was simply a reiteration of its original audit response letter. The OES states that there is no need for it to specifically evaluate its notification process because the OES uses these same tools for all other types of disasters and emergencies daily. We disagree. In a meeting held on August 14, 2001, the deputy director of Emergency Operations, Planning and Training Division agreed that a formal, periodic assessment of how the notification process is working would be beneficial to identify process improvements. The deputy director also told us that the OES' blackout notification process improved upon its prior notification procedures. For example, it allowed for expanded use of its Emergency Digital Information Service and the incorporation of its Response Information Management System. Therefore, we would expect the OES to ensure that these new enhancements are effective.

The OES stated further that even though there are some issues unique to blackouts, there is no need to designate or train staff to respond to local government's inquiries because these capabilities exist within its structure already. We disagree. Because the OES did not designate and train staff to accept these inquires, there is a potential that when the local governments contact the OES for assistance, they may get passed on to multiple staff and not receive the help they need at all. Moreover, because as the OES states there are issues that are unique to blackouts, despite their technical expertise in overall emergency management operations, staff may not be able to assist the local government in using OES' Electric Power Disruption Toolkit for Local Government.

Finding #3: Although its communication systems are redundant, the CNG's lack of maintenance weakens these systems.

The CNG's outage plan specifies that the armories are to rely on commercial telephone systems as the primary means of communication. If commercial services are unavailable, the plan directs staff to use two alternative communication methods: high frequency radios (HF radios) and cellular phones. Although the CNG's outage plan appears reasonable in that it provides for redundant methods of communication, because the CNG does not ensure that its HF radios and cell phones are intact and operational, it cannot be certain that these alternatives will be available when necessary.

To strengthen its readiness for blackouts, the CNG should develop a plan that sets forth inspection dates for each location with a HF radio, the person responsible for the inspection, and a date certain for the completion of all repairs; and continue with these maintenance checks on an ongoing basis. In addition, the CNG should establish a process to periodically check that each cell phone is operating and the batteries are fully charged.

Department Action: Partial corrective action taken.

The CNG provided us with a maintenance schedule for its 19 HF radios including a party responsible for inspections and an inspection date. The CNG plans to inspect all the radios by March 2002. The CNG also provided information demonstrating that it had made six of its planned visits. However, the CNG still needs to establish completion dates for necessary radio repairs.

The CNG also reported that it is recalling the cell phones it issued to the armories in an effort to reduce its telecommunications expense.

Finding #4: The CNG does not monitor its tactical generators' operability.

The CNG's outage plan specifies that tactical generators may be used in CNG facilities when power is essential for safety, security, and mission requirements. The CNG normally uses tactical generators when staff are in the field and need a power supply for their equipment. Although these generators cannot be connected to the buildings' electrical system to supplant traditional power

sources, they can be used to operate portable light fixtures and radios thereby contributing to the normal operation of a CNG facility during a blackout. However, the CNG does not ensure its facilities periodically test its tactical generators. Therefore, the CNG has limited its assurance that it can use these generators in the event of a blackout.

We recommended that the CNG develop policies and procedures for testing and maintaining its tactical generators and include these policies and procedures in its outage plan. In addition, the CNG should continue to monitor the operational status of these generators.

Department Action: Partial corrective action taken.

The CNG reports that it has amended its Power Outage Plan, which now includes a requirement for field commanders to test their units' tactical generators monthly. The headquarters staff will also review monthly maintenance reports the units submit in order to monitor the generators' operational status.

Finding #5: The CNG does not include in its plan or adequately monitor its headquarters' back-up generators.

The Department of General Services expects state agency and department emergency plans to address how they will ensure that any back-up generator sources are tested and readily available. Although the CNG's plan addresses tactical generators, it does not address the back-up generator in its headquarters building. According to the Director of Plans, Operations and Security, once a week an automatic timer trips and the back-up generator will start up and run for several minutes to ensure the generator is working properly. Because the back-up generator is critical to the CNG's Joint Operations Center during a blackout, we would expect it to include this generator in its plans and to have policies and procedures in place for tracking the weekly generator test and as part of that test, inspecting the generator for sufficient fuel, leaks, or other malfunctions. However, according to the Military Support Civilian Authorities Communications Officer responsible for the headquarters' generator, no such policies or procedures exist; he simply listens for the generator to start up each week.

We recommended that the CNG update its outage plan to address its headquarters' back-up generator that it needs to operate its Joint Operations Center, periodically inspect it for leaks, check its fuel

levels and other critical elements, and execute a maintenance contract to ensure that more extensive inspections occur on an ongoing basis.

Department Action: Partial corrective action taken.

The CNG amended its Power Outage Plan to include weekly tests of its headquarter's back-up generator. In addition, the CNG developed a preventative maintenance inspection checklist to follow when testing the generator. Finally, the CNG provided a description of its scope of work for a commercial contractor to service its generator. The CNG has not let the contract yet as it is trying to determine how the new contract affects an existing warranty.

STATE-OWNED INTELLECTUAL PROPERTY

Opportunities Exist for the State to Improve Administration of Its Copyrights, Trademarks, Patents, and Trade Secrets

REPORT NUMBER 2000-110, NOVEMBER 2000

Audit Highlights . . .

Our review of the administration of state-owned intellectual property disclosed the following:

- ☑ *A lack of sufficient knowledge by state agencies of the intellectual property that they own can hamper the State's protection of its interests.*
- ☑ *Not only is state-level direction for administering intellectual property limited, but state agencies have either no or incomplete policies for its management.*
- ☑ *Although our survey of state agencies and other work we performed identified more than 113,000 items of state-owned intellectual property, the State likely owns more.*

Intellectual property typically consists of copyrights, trademarks, patents, and trade secrets. We concluded that many state agencies were not sufficiently knowledgeable about the intellectual property they own. Lacking adequate knowledge of their intellectual property ownership and rights, state agencies could fail to act against those who use the State's intellectual property inappropriately. Inappropriate use includes unauthorized use of state trademarks and improperly profiting on products developed at state expense. Further, we noted that state-level direction for administering intellectual property was limited. The few state laws that addressed intellectual property did so in piecemeal fashion. We also pointed out that state agencies had either no or incomplete written policies for managing their intellectual property. Finally, although our survey of state agencies and other work we performed identified more than 113,000 items of state-owned intellectual property, the State likely owns more. We reported the following specific findings:

Finding #1a: State agencies do not always know about the intellectual property they own or their rights to own it.

Our survey of state agencies and other work we performed revealed that many agencies do not realize they own intellectual property, are not aware of the quantity of intellectual property they own, or are unclear or incorrect about their ability to own or formally protect through registration their intellectual property. Not being knowledgeable about intellectual property increases the risk that state agencies will not act against others that misuse their protected material. Indications that all state agencies may not be aware of all intellectual property they own and that the State actually owns more intellectual property than we disclose in our report include:

- Some state agencies did not identify all intellectual property they own in their survey responses. Although our search of the copyright database of the federal Copyright Office disclosed approximately 1,600 registered copyrights owned by 60 state agencies, only 23 agencies identified 400 such copyrights in their survey responses.

- Some agencies either did not or could not tell us how much intellectual property they own. For instance, despite acknowledging that it possesses intellectual property, one state agency reported that it did not have the resources to quantify its holdings. The Copyright Office database shows that this agency in fact owns 303 registered copyrights.

- Some state agencies appear to be unclear or incorrect about their ability or right to own or register intellectual property. Although decisions in two courts cases support state agencies' legal authority to own and protect their intellectual property, nine state agencies stated in their survey responses that they had either no legal authority to formally register their intellectual property or no authority to own it.

- Some state agencies indicated that they own more intellectual property than they disclosed in their survey responses. For example, one department stated that because of the vast array of its programs and the extensive number of contracts and grants awarded, it is difficult to provide an exact count of the intellectual property it owns.

- Our reviews at seven state agencies to verify information on their survey responses, although limited in scope, resulted in the identification of additional intellectual property.

Finding #1b: State-level direction for administering intellectual property is limited, and state agency policies are generally incomplete.

State law does not expressly authorize all state agencies to own and protect all their intellectual property. When it does address intellectual property, it typically allows a specific state agency to own a certain type of intellectual property or authorizes state agencies to protect certain products such as software that can be safeguarded by copyrights. Further, statewide policies, such as those found in the State Administrative Manual or the State Contracting Manual, do not address intellectual property. When it comes to internal policies, only 43 of the 220 state agencies report having

written policies concerning intellectual property. Interestingly, none of these policies provides state agencies with complete guidance for, among other things, identifying products that could be intellectual property, determining whether to formally protect intellectual property, and enforcing their rights against those infringing on the intellectual property. These findings indicate a need for centralized state guidance concerning intellectual property administration and a campaign to educate state agencies on their intellectual property rights and responsibilities.

To help resolve the above concerns, we recommended that the Legislature designate a single state agency as the lead for developing overall policies and guidance related to state-owned intellectual property. This lead agency should also, as necessary, recommend any statutory clarifications necessary to better protect the State's intellectual property. This agency should also have the ability to issue guidelines that all state entities could follow. The lead agency should be responsible for, among other tasks:

- Developing an outreach campaign informing state agencies of their rights and responsibilities concerning intellectual property.

- Establishing guidelines for use by state agencies in administering their intellectual property, including establishing policies concerning the criteria for determining which products will be treated as intellectual property and which should be placed into the public domain.

We also recommended that the Legislature clarify state law to specifically allow state agencies to own, and if necessary, formally register intellectual property they create or otherwise acquire when it is deemed to be in the public's best interest.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Finding #2: Possible conflict between intellectual property laws and information access laws can be addressed.

A concern arising from state ownership of intellectual property is that ownership conflicts with the principle of open government—as embodied in the California Public Records Act—by restricting the dissemination of information. The argument is that state agencies could use intellectual property laws to deny access to information they create that would otherwise be accessible. Although

this threat seems remote in California, it could be addressed by the Legislature's declaration that intellectual property law protection does not necessarily preclude state agencies from disclosing information. The State could also address this issue by structuring its ownership rights to encourage information dissemination while discouraging unauthorized economic gain or other inappropriate use. For example, the State could provide the public with information that is subject to a license or terms-of-use agreement. This license or agreement would restrict the information's use to private, noncommercial purposes. Consequently, the license or agreement would allow public access to the information and, indeed, the right to use the information in any acceptable manner.

We recommended that the Legislature clarify existing law to declare its intent that protection of state-developed products under intellectual property laws does not preclude state agencies from disclosing information otherwise accessible under the California Public Records Act. We also recommended that the agency designated by the Legislature to be the lead for issuing intellectual property-related policies and guidance be responsible for developing sample language for licenses or terms-of-use agreements that state agencies can use to limit the use of their intellectual property by others to only appropriate purposes.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Finding #3: Poor patent practices could prove costly to the State.

The State does not have a statewide policy for patents to help ensure that it retains ownership of the rights to potentially patentable products or processes developed by its employees working on state time using state resources. Under some circumstances, state employees could secure the patent rights to inventions created on the job and require the State to acquire licenses to use them. To avoid the possible loss of patent rights, private-sector firms and research universities can require their employees to sign documents acknowledging that the rights to any patentable products developed as part of their jobs belong to the employers. These documents are called invention assignment agreements. These agreements can help the State preserve its rights to assert patent ownership and could help strengthen the State's claim of ownership in court should a patent dispute arise.

We recommended that the agency designated by the Legislature to be the lead for issuing intellectual property-related policies and guidance be responsible for developing sample invention assignment agreements that state agencies can consider if they believe it is necessary to secure the rights to potentially patentable items created by their employees on state time using state resources.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Finding #4: Standard contract language raises questions that should be considered further.

During our review, we noted standard contract language regarding intellectual property rights that raises questions as to whether it is in the public's best interest. The State's inclusion of this language in its contracts may result in missed opportunities to either lower contract costs or, if a licensing arrangement can be made, to establish additional revenue sources. The Department of General Services requires state funded contracts for the development of information technology that exceed $500,000 to include standard language that essentially gives the contractors a free license to use and sell intellectual property developed under these contracts. Thus, it raises the question as to why the State is apparently giving a portion of its intellectual property rights to contractors without considering the potential value of these rights.

The chief counsel of the Department of General Services comments that the existing language is an appropriate balance of certain financial factors plus others, including the unknown value of the rights to intellectual property before contracts are begun and the need for contractors to use incremental discoveries for other customers without being burdened by costly tracking and accounting procedures. Although the chief counsel's arguments against changing the standard language may have merit, it still seems questionable to us that the State would enter the competitive process for selecting contractors having already given them a free license to use and sell intellectual property they ultimately develop for the State.

We recommended that the Legislature consider whether the interest of the public is best served when the State uses standard contract language that essentially gives contractors a free license to use and sell intellectual property they develop for the State.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

STATE OF CALIFORNIA

Unnecessary Administrative Fees Increase the State's Cost of Contracting With California State Universities

REPORT NUMBER 2000-001.4, NOVEMBER 2000

Audit Highlights . . .

Our review of the State's contracts with the California State University (CSU) system revealed that:

- ☑ *While the contracts with CSU entities appear appropriate, state departments have unnecessarily paid or agreed to pay fees to administer these contracts.*
- ☑ *State departments will pay the CSU Board of Trustees $1.5 million to simply act as an intermediary between the State and the CSU foundations.*
- ☑ *State departments could have saved $1.4 million in administrative fees had they negotiated the average 15 percent rate for more of the contracts.*
- ☑ *By allowing CSU foundations to purchase goods and services for them, rather than doing it themselves, state departments paid $102,000 more than necessary.*

State departments (departments) contract for billions of dollars of services every year. To obtain needed services, departments sometimes contract with entities in the California State University (CSU) system for the expertise of the faculty, staff, and students at various CSU institutions. From July 1998 to February 2000, state departments had contracts worth $143 million with the CSU system. We reviewed a sample of 183 contracts worth $93 million and found CSU faculty and students appropriately performed the majority of the work. Furthermore, when subcontractors were hired, they were properly selected through a competitive bid process, if bidding was required. While the contracts with CSU entities appear appropriate, we did find that some state departments have unnecessarily paid or agreed to pay the university system $3 million in fees to administer these contracts. Specifically, we found:

Finding #1: Contracting with the Board of Trustees of the CSU is more costly to the State.

Many departments are paying more than necessary for administrative fees because they are contracting with the CSU Board of Trustees (board) instead of negotiating contracts directly with the campuses. The board acts as an intermediary for departments and the CSU foundation that provides the services. It establishes master agreements with CSU foundations, enters into an interagency agreement with departments, and then issues work authorizations to the foundation that will provide the contracted services. Based on the terms of existing agreements, departments will pay the board about $1.5 million for this limited service.

We recommended that departments avoid contracts using fiscal intermediaries, such as the board, that add little value.

Department Action: Corrective action taken.

Although we addressed this recommendation to all departments, we only elicited a formal response from the Department of Health Services because we discussed certain details regarding one of its contracts as an example of the condition we noted.

In April 2001 the Department of Health Services issued a policy memo to its management staff instructing them to contract directly with individual CSU campuses and foundations to avoid incurring unnecessary administrative costs charged by the trustees. The department also developed an on-line CSU contract model and user guides to assist staff when contracting with the CSU system.

Finding #2: Understanding the actual costs underlying administrative fees could enable departments to negotiate lower rates.

Some departments negotiate rates for administrative fees without sufficient knowledge of the cost the CSU campuses actually incur for administrative activities. For example, rather than inquiring about the level of administrative activities needed for a particular agreement, many times departments simply agree to pay an administrative rate equal to the maximum rate allowed in other contracts CSU foundations have with the federal government. This leaves the departments ill-equipped to bargain for more competitive rates.

In our sample of 183 contracts, fees generally ranged from 8 percent to 25 percent of the contracts' direct costs and covered expenses for administrative support as well as for managing personnel, finances, and facilities. The average administrative fee for the contracts reviewed was 15 percent of total direct costs. However, state departments often paid more than 15 percent. Taking into account only those 36 contracts not brokered by the board in which the administrative fee exceeded 15 percent, the State could have saved $1.4 million had the contracting department negotiated the average 15 percent fee.

We recommended that state departments negotiate rates for administrative fees based on a fuller understanding of the actual costs comprising the rate.

➲ ***Department Action: None.***

Although we addressed this recommendation to all departments, we only elicited a formal response from the Department of Transportation (department) because we discussed certain details regarding one of its contracts as an example of the condition we noted.

The department stated that it accepts the federal rate for administrative costs in cases where the agreements are financed by federal funds. The department believes its current process of relying on the federal indirect cost rate-setting process, pre-award, and periodic post-audits ensures that indirect costs charged on contracts are reasonable. However, according to a representative of the federal Department of Health and Human Services, the federal cognizant agency for the department, the federal indirect cost rate represents a maximum administrative fee rate that an entity such as a CSU can charge in federally funded contracts. There is no prohibition for an organization to negotiate a lower administrative fee rate when appropriate. Therefore, we believe the department should negotiate rates based on a fuller understanding of the actual costs comprising the rate rather than simply accepting the maximum federal rate.

Finding #3: Departments may pay fees unnecessarily if CSUs procure goods and services from subcontractors.

Departments pay more in fees because CSU campuses hire subcontractors and purchase goods for them, although the departments could procure these services and goods more cheaply themselves or seek to avoid the amount of administrative fees tacked on to the cost of these items. We identified eight contracts in which campuses entered into large subcontracts for printing services and training materials that the departments could easily have procured themselves—and saved the State $102,000 in administrative fees.

We recommended that departments contract directly with third parties for goods and services when it is more cost-effective, or avoid payment of the administrative fees tacked on to the cost of goods and services departments could procure at reduced costs on their own.

Department Action: Corrective action taken.

Although we addressed this recommendation to all departments, we only elicited a formal response from the Commission on Peace Officer Standards and Training (commission), the Department of Health Services, and the Department of Parks and Recreation because we discussed certain details regarding their contracts as examples of the conditions we noted.

In response to our recommendation, the commission reported in May 2001 that it does not have the staff to directly purchase all materials. However, it has been successful in securing agreement with CSU foundations to withhold administrative fees related to costs for simple purchases of materials or rental of equipment or facilities.

The Department of Health Services issued a policy memo to its management staff in April 2001 instructing them to evaluate the necessity of using subcontracts under university agreements and to eliminate their use whenever it is more practical and cost-effective for the department to directly secure the services of a third party. The department also developed an on-line CSU contract model and user guides to assist staff when contracting with the CSU system.

The Department of Parks and Recreation has updated its user's guide for contract administration and its administrative manual to provide additional guidance to its contract writers. Among other provisions, this guidance requires contract writers to contract with third parties for goods and services, when cost effective, to avoid payment of administrative fees added to the cost of these goods and services.

ENERGY DEREGULATION

The Benefits of Competition Were Undermined by Structural Flaws in the Market, Unsuccessful Oversight, and Uncontrollable Competitive Forces

REPORT NUMBER 2000-134.1, MARCH 2001

Audit Highlights . . .

Deregulation of California's electricity market has failed, not as the result of any single cause, but, rather of a complex combination of factors, including:

- ☑ *Deficiencies in the rules governing the power markets that were created, such as the requirement that investor-owned utilities sell all of the power they generated themselves and purchase all of their electricity through sequential short-term markets.*
- ☑ *The existence of sequential short-term markets that have encouraged some market participants to engage in strategic bidding, which has contributed to higher wholesale prices.*
- ☑ *Misjudgments on the part of regulators as to the efficacy of their corrective actions, including decisions made by the Federal Energy Regulatory Commission and the California Public Utilities Commission.*

At the request of the Joint Legislative Audit Committee, we assessed the Power Exchange's (PX) and the Independent System Operator's (ISO) structure, operations, and overall functionality and the extent to which the activities of the two contributed to the rising cost of wholesale electricity in California. Based on our review, we found the following:

Finding #1: The multiple sequential markets operated by the PX and ISO resulted in strategic bidding.

AB 1890, the legislation requiring the deregulation of California's electrical market, included provisions for creating two nonprofit institutions: the PX[1], intended to provide an open, competitive commodity market for buying and selling wholesale electricity; and the ISO, intended to centrally manage and control the State's transmission grid. However, the relationship between the PX and ISO was over-designed. Rather than creating one market or entity through which the purchasing and selling of wholesale electricity took place, the two organizations were structured to operate several markets in sequence.

Market participants soon recognized the potential for strategic bidding and adopted various tactics to manipulate wholesale electricity prices. Both buyers and sellers appear to have bid strategically. The market participants' strategic bidding had the result of driving energy sales and purchases out of the PX's primary market and into the ISO's secondary market, which was designed to accommodate only 3 percent to 5 percent of the State's electricity needs. The use of the ISO as a primary market is one factor that contributed significantly to high energy prices and crisis operations.

[1] On January 31, 2001, the PX suspended trading and filed for bankruptcy shortly thereafter.

To reduce market participants' opportunity for strategic bidding through underscheduling, we recommended that the ISO:

- Cease conducting real-time markets. To fulfill its real-time energy needs, the ISO should undertake to execute forward contracts with generators to provide imbalance energy and reserves for reliability services.

- Consider penalizing scheduling coordinators that submit schedules that do not reflect real-time demand and supply conditions. Penalties would be shared amongst buyers and sellers.

In addition, we recommended that the ISO cease purchasing ancillary services in the spot market and instead:

- Make purchases through secret bids for most of its forecasted ancillary services requirements and significantly reduce its use of spot markets to purchase energy.

- Purchase any short-term ancillary services requirements at individually determined prices, as opposed to paying one price for all such purchases at any point in time.

- Consider the option of contracting for generation capacity. If contracted supply exceeds demand the ISO should be allowed to sell unneeded capacity at cost plus an administrative fee to others through the PX or similar markets.

ISO Action: None.

The ISO noted that it believes that none of these options necessarily addresses the underlying source of the market's underscheduling and strategic bidding problems; however, underscheduling and strategic bidding have diminished due to a combination of different market conditions such as lower demand for electricity, the Department of Water Resources making significant forward power purchases, and the Federal Energy Regulatory Commission (FERC) establishing more effective market power mitigation measures.

The ISO also stated that the issue of whether it is an appropriate entity to be entering into long-term contracts is under question and is being addressed as a matter of state policy. The ISO reported that the Department of Water Resources is entering into long-term contracts in a way that is consistent with several

of the recommendations we made including paying on an as-bid basis, maintaining a higher degree of confidentiality about purchase prices, and selling back unneeded energy.

Finding #2: The imposition of price caps may have contributed to escalating prices.

Both the ISO and FERC have used price caps in an effort to control the prices paid in the California market, with mixed success. First, even when demand in the PX was low, the ISO price cap became the minimum bid in some peak demand hours. Additionally, in times of high demand, it is unclear whether any price cap is effective, simply because sellers can bid into the ISO's market through out-of-market transactions, which are not subject to the price cap. The result is higher energy prices, despite the effort to control them.

We recommended that if the ISO is unsuccessful in limiting spot market purchases to very small amounts, it should use price caps only if markets are found to be noncompetitive and supply is being withheld to force prices higher.

ISO Action: Corrective action taken.

The ISO reported that the FERC approved its Market Stabilization Plan, which includes new forward energy markets and resource-based bid caps tied to the cost of specific generation resources.

Finding #3: The ISO lacks authority to effectively schedule power plant outages.

Another weakness in the structure of the State's power market involves the ISO's lack of authority over generator behavior with respect to scheduled plant outages for maintenance. In light of the evidence that the market is not yet workably competitive, it is unreasonable to grant generators full autonomy concerning the scheduling of plant outages. In fact, despite the ISO arguing that it needed to control scheduled plant maintenance outages in order to be able to effectively balance the system's reliability; the plant owners were allowed to maintain control over such outages. The ISO's lack of authority in this area contributed to the problems in the winter of 2000, as scheduled plant outages coincided with high demand, decreasing supplies, and unscheduled outages due to problems with equipment. If the ISO had some control over the scheduled outages, as do the independent system operators for

PJM, New York, and New England, it could have coordinated the scheduled outages more effectively to help alleviate problems with shortages in supply.

We recommended that the ISO coordinate with power generators in scheduling outages for plant maintenance over the next two to three years, or until a competitive market is established. This may not necessarily require that the ISO determine outage schedules, but it will at a minimum require generator participation in scheduling known outages well in advance and in keeping to the schedule established.

ISO Action: Partial corrective action taken.

The ISO reported that it filed a Tariff amendment with the FERC requesting authority to manage power plant maintenance and outages; as of August 2001, the ISO's latest report, its Tariff amendment was still pending before the FERC. In addition, the ISO stated it is working with state legislators to ensure enhanced coordination of scheduled power plant outages on an ongoing basis.

Finding #4: Data published on the PX and ISO Web sites may adversely affect competitive markets.

Within the California market, specific bidding data are confidential; nevertheless, the ISO and, when it was operating, the PX, periodically published market-clearing price and quantity data on their respective Web sites. The PX also published its market models and gave market participants access to data that would enable them to formulate their own econometric models, such as data on market prices and volume.

Some argue that it was necessary for the ISO and the PX to publish as much data on price and volumes as possible so as to encourage new entry into the market. Although the data have been published only after the fact, when coupled with the published PX pricing model, this meant that predicting market-clearing prices became increasingly easy. Even using stale data, market participants could begin to develop their own models and bidding strategies, and to check their bidding strategy assumptions and adjust them where necessary. With respect to the PX, this point is moot, because the PX has ceased trading in its markets; the ISO, however, is still operating.

We recommended that the ISO:

- Avoid making available to the public any new oversight and market-monitoring models developed.

- Delay making public for at least one year, data for bidding and winning bids. This is especially critical for information concerning long-term contracts the ISO might enter into to meet its ancillary services needs.

ISO Action: Corrective action taken.

The ISO stated that pursuant to the FERC's April 26, 2001, Order, it has submitted to the FERC confidential reports examining potential anti-competitive bidding practices. In addition, although we recommended a one-year delay before publishing bidding data, the ISO reports that the FERC has established as appropriate a six-month delay. The ISO also noted that as of May 2001 it ceased making certain real-time market information available on its Web site.

ENERGY DEREGULATION

The State's Energy Balance Remains Uncertain but Could Improve With Changes to Its Energy Programs and Generation and Transmission Siting

REPORT NUMBER 2000-134.2, MAY 2001

Audit Highlights . . .

Despite programs to add supply and reduce demand, the State's energy balance remains uncertain:

- ☑ *Even with projections to the contrary, there is little assurance that the State will meet energy supply needs this summer.*
- ☑ *The State Energy Resources Conservation and Development Commission's (energy commission) AB 970 demand reduction programs are estimated to save 281 megawatts at June 1 2001, however, over one-half of this savings is expected to come from programs that are voluntary in nature.*
- ☑ *Since 1996 the energy commission has approved 12 power plants, but only 4 were approved within 12 months, its statutory goal.*
- ☑ *Despite adding three new processes to hasten power plant siting, only one will add a significant amount of energy to the State's supply in time for summer 2001.*

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The Joint Legislative Audit Committee requested that we assess the structure, operations, and overall functionality of the California Power Exchange (PX) and the California Independent System Operator (ISO) and if these contributed to the rising cost of wholesale electricity in California. In March 2001 we issued report number 2000-134.1 on the PX and ISO titled, *Energy Deregulation: The Benefits of Competition Were Undermined by Structural Flaws in the Market, Unsuccessful Oversight, and Uncontrollable Competitive Forces*. However, while working on that report, we realized the integral roles played by the California Energy Resources, Conservation and Development Commission (energy commission) and the California Public Utilities Commission (CPUC) in California's deregulated energy market. Thus, we issued this second report on energy deregulation, focusing on the energy commission's and the CPUC's responsibilities in the State's energy market.

Finding #1: The ISO and energy commission's projections of the State's likely balance between electricity supply and demand for summer 2001 are based on assumptions about power outages, customers actions, and other factors that may not come true.

Despite projections to the contrary, there is little assurance that the State will meet its energy supply needs during the summer of 2001. Responding to the increased public awareness of California's energy crisis, the ISO and energy commission released projections of the balance between electricity supply and demand. These projections, however, are based on assumptions about power plants not operating, customer actions, and several other factors that may not prove true. Furthermore, the projections do not consider transmission limitations between certain parts of the State or expand the prediction to include more than one possible outcome.

☑ *The California Public Utilities Commission (CPUC) does not have an expedited transmission siting process for urgent projects.*

☑ *Although the CPUC relies on them for approving transmission projects, the investor-owned utilities' projections of transmission demand growth may not be reliable.*

Finally, because of the State's role in purchasing electricity for the investor-owned utilities, it remains unclear whether retail competition is consistent with the State's goal of returning the utilities to a creditworthy status.

We recommended that the energy commission consult with the ISO and develop an annual projection of summer supply capacity compared to peak demand that acknowledges the full range of constraints within the State's electricity system, including transmission constraints. As part of this projection, the energy commission should provide the Legislature with a range of possible supply and demand outcomes that reflect the underlying assumptions' likelihood of proving true.

Commission Action: Partial corrective action taken.

The energy commission has yet to submit its 6-month response to this audit recommendation as requested. However, in its 60-day response, dated October 5, 2001, the energy commission indicated that it has been tracking supply and demand information for the governor, Legislature, and others. In addition, the energy commission stated that it has and will continue to work with the ISO to collectively assess the availability and constraints of existing electricity resources.

Finding #2: The energy commission's Peak Load Reduction Program may miss its estimate of electricity to be saved by June 2001.

The energy commission estimated that by June 1, 2001, its Peak Load Reduction Program would provide 281 megawatts (MW) of peak demand reduction. However, the energy commission may be overly optimistic in its estimate. This is because more than half of its estimated 281 MW savings are projected to come during periods of high demand from the voluntary curbing of electricity use in commercial and state government buildings located throughout California. However, actual energy savings will depend on the operators' responses to potentially frequent requests to reduce electricity use, thus the actual megawatt savings this program will provide are uncertain.

Also, the energy commission's efforts to monitor its water-systems equipment program, which subsidizes the replacement of inefficient water pumps and equipment with more efficient ones, may not be sufficient to ensure that each project schedule will actually be completed by June 1, 2001, in time to provide the planned peak demand reduction for June, which represents 17 percent of its estimated peak energy savings.

We recommended that the energy commission eliminate the override function from the commercial building program guidelines and contract language so that building managers more readily comply with directives to reduce lighting and air conditioning levels as agreed. We also recommended that as a condition of program participation, the energy commission should require commercial building program participants to meet specified compliance levels for a certain period of time, such as 24 months. If the compliance levels are not met, the participants should be penalized.

Finally, we recommended that the energy commission develop a plan to actively evaluate itself and program participants in all components of the Peak Load Reduction Program against set milestones such as:

- Securing a certain number of participants by milestone dates.
- Verifying that equipment is ordered and delivered by scheduled due dates.
- Projects are installed, completed, and tested according to scheduled dates.

Commission Action: Partial corrective action taken.

The energy commission has yet to submit its 6-month response to this recommendation as requested. However, in its 60-day response, dated October 5, 2001, the energy commission reported that the utilities will and the ISO may assess penalties if building operators do not provide contracted load relief. The energy commission stated that this is as much assurance of performance as they could achieve independently. The energy commission told us that it is actively evaluating the peakload reduction program. In addition, its managers are monitoring each contract relative to its milestones. The energy commission reports that it is conducting site visits where possible and has contracted with an outside vendor to provide monitoring and program impact verification.

Finding #3: The CPUC's energy efficiency programs may not achieve planned peak energy savings and cost much more than larger commercial and industrial peak energy savings programs.

Through its self-generation program, the CPUC subsidizes electricity customers' purchases and installation of solar panels, fuel cells, and nondiesel internal combustion engines, to allow these customers to generate their own electricity rather than drawing energy from the transmission grid. However, the CPUC allows customers their choice of the type of self-generating technology they wish to install rather than focusing on maximizing the reduction in peak demand. As a result, customers' technology choices will greatly affect the megawatt savings the CPUC will achieve.

Additionally, the CPUC's new demand control efforts, which include a plan to adjust thermostats during times of peak electricity use, may fall short of its estimated megawatt savings goal of 8 MW in 2002. Under this plan, participants will have the ability to override the signal to adjust their thermostats, partially or wholly negating any energy savings.

In addition, the Web site the CPUC directed PG&E to develop calls for PG&E to duplicate information already residing on the respective Web sites of PG&E, private entities, and public entities. Thus, we believe the $3 million annual cost for the Web site is a poor use of ratepayer funds.

Finally, the self-generation and demand control programs will cost the ratepayers of the three investor-owned utilities $551.5 million, nearly six times more costly on a per megawatt saved basis than the energy commission's Peak Load Reduction Program. Even though AB 970 requires the CPUC to address small energy customers, it does not preclude the CPUC from including larger industrial and commercial customers in its demand reduction programs. Therefore, we questioned whether the CPUC should continue to commit utility ratepayers' funds only to residential and small commercial programs when funds collected from and applied to larger ratepayers could achieve greater peak energy savings.

We recommended that the CPUC:

- Amend the new residential and small commercial pilot programs to remove the override option from the program and to require participants to reduce peak demand as and when directed.

- Remove the Web site from its portfolio of demand control programs.

- Increase its vigilance in its oversight of the investor-owned utilities' administration of energy efficiency programs.

- Give priority to conservation measures for those types of customers who will produce the most energy savings.

➲ ***CPUC Action: Partial corrective action taken.***

In its 6-month audit response, the CPUC stated that is in the process of formally reviewing the policies and procedures for administering energy efficiency programs. This review began in late August 2001. The CPUC did not specify a completion date. The CPUC provided no response covering their efforts to implement our other recommendations. These recommendations remain valid because:

- Under the demand control pilot program participants can override the signal to adjust their thermostats, thereby diminishing the savings the CPUC hopes to achieve.

- The Web site CPUC directed PG&E to develop was duplicative of existing sites. Thus, the $3 million annual cost to maintain the Web site is a poor use of ratepayer funds.

- The CPUC is not precluded from including larger industrial and commercial customers in its demand reduction programs that could achieve greater peak energy savings for the cost than would be the case by including only small energy customers.

Finding #4: The potential for wide swings in electricity supply may require that the State augment its role in energy planning.

After the State deregulated the electricity industry, the energy commission no longer played a role in restraining the State's level of electricity supply. Instead, the State relied on the competitive market to encourage the construction of sufficient power plants to ensure an adequate supply of power. However, relying on the marketplace to determine when to increase supply may not be in the State's best interests. Because power plants take a significant amount of time to site and construct, the industry may not be able to respond quickly enough to market signals to ensure that

the State is not exposed to a boom-bust cycle. To avoid these large fluctuations in electricity supply, it may be valuable for the State to augment its planning role, ensuring that California never reaches extreme levels of oversupply or undersupply.

We recommended that the Legislature and energy commission consider augmenting the energy commission's role in electricity planning to help ensure the State avoids large swings in the supply of electricity relative to demand. For example, expanding the energy commission's existing planning role to include integrating supply and demand projections and to use them as a basis for making decisions on whether to site new power plants.

Commission Action: Partial corrective action taken.

The energy commission has yet to submit its 6-month response to this audit recommendation. However, in its 60-day response, the energy commission reported that it was preparing an assessment of the projected supply and demand for electricity, natural gas, and related issues over the 10-year period 2002 through 2012, with the report's completion date scheduled for November 2001. The energy commission reported that it planned to make this report available to the California Power Authority to assist in developing its investment plan. Finally, recognizing the volatility in the energy markets, the energy commission indicated that it was considering updating its demand/supply assessment on an annual basis.

Finding #5: The energy commission has made changes to improve its siting process but is not evaluating the effectiveness of those changes.

In response to a legislative mandate, in March 2000, the energy commission issued a report on improvements that it could make to its siting process. As of April 1, 2001, the energy commission stated that it had implemented over half of the changes it identified. However, the energy commission has not developed methods to judge the effectiveness of its changes. For example, to prevent delays, the energy commission changed its regulations to specify that outside parties could only request information on applications within 180 days of the date the application is complete. However, the energy commission has not attempted to measure whether this new procedure has actually prevented the delays it previously identified. Thus, the energy commission cannot guarantee that this change and others it has made have actually improved the generation siting process as intended.

We recommended that the energy commission establish an evaluation plan to assess the impact of recent changes to its process for siting power plants.

Commission Action: Corrective action taken.

In its 60-day audit response, dated October 5, 2001, the energy commission reported that it had developed a power plant permitting database to record key events and other data relating to the power plants being reviewed or permitted. The energy commission stated it has the ability to query the database to determine if there are any measurable improvements attributable to changes it has made to the permitting process. In addition, the energy commission stated it intended to continue to hold post-certification debriefings with stakeholders to gather qualitative information on the outcomes of the permitting process.

Finding #6: Having utilities responsible for transmission planning may hinder the development of new transmission lines.

The investor-owned utilities are primarily responsible for transmission planning, determining through their own separate analyses of demand growth what new transmission lines are needed and where. The ISO and CPUC coordinate, plan, and oversee the expansion of the State's transmission grid. Because the three investor-owned utilities create three individual transmission expansion plans, based on potentially varying assumptions of the future demand growth in their respective service areas, the ISO's ability to create a comprehensive statewide expansion plan may be hindered. Also, the investor-owned utilities may have incentives that conflict with their responsibility to expand the grid where necessary. Therefore, the investor-owned utilities' demand analyses may not be the best basis for determining when and where transmission lines are needed. In relying on these analyses to determine transmission line expansion, rather than on analyses prepared independently, the ISO and CPUC lack assurance that the utilities' proposed transmission projects are optimizing the transmission grid.

We recommended that the energy commission make regional demand growth projections for the ISO and CPUC to use in their transmission planning and siting processes so that the State has an independent projection of demand growth on which to base transmission expansions.

Commission Action: Partial corrective action taken.

The energy commission has yet to submit its 6-month response to this audit recommendation. However, in its 60-day response, the energy commission reported that its electricity demand analysis and projections are available to and can be used by the CPUC and the ISO. In addition, the energy commission stated that it works with many out-of-state electricity planning entities and utilities to establish a common understanding of the Western Systems Coordinating Council's regional developments.

Finding #7: The CPUC's transmission siting process is not responsive to the current energy crisis.

Although its is responsible for siting the electrical transmission lines that the investor-owned utilities propose, the CPUC does not have an expedited transmission siting process that could better assist California's recovery from the energy crisis. Moreover, in almost half of the CPUC's siting cases using the environmental review process outlined in the California Environmental Quality Act (CEQA), the CPUC significantly exceeded the 180- and 365-day goals CEQA sets for completing environmental reviews. A lack of adequate transmission capacity in some areas of the State can be devastating—transmission constraints have already caused rolling blackouts and have the potential to do so again in the near future. Also, long delays in siting added transmission could slow the State's recovery from the current energy crisis.

We recommended that the Legislature:

- Create an expedited electricity transmission siting process for projects that are needed for short-term transmission system reliability.

- Institute a coordinated electricity transmission siting process as it relates to other agencies similar to the coordinated power plant siting process used at the energy commission.

Legislative Action: Unknown.

Finding #8: The future of consumer choice is unclear.

In California's deregulated electricity industry, energy customers can choose to stay with the investor-owned utilities or purchase their electricity from another provider. The CPUC and the Legislature

had high expectations that consumer choice would increase competition and lead to lower electricity prices. However, Californians never fully realized these benefits of consumer choice because certain features of deregulation and its implementation kept consumer choice from flourishing. Now, the future of consumer choice is in doubt because the State has become the main purchaser of wholesale electricity for the investor-owned utilities, negotiating long-term contracts with energy generators. The goals of consumer choice may conflict with the State's goal of returning the investor-owned utilities to creditworthy status—because expanding competition at this point might result in the State paying for unneeded power.

We recommended that in assessing the future role of consumer choice, the CPUC should consider the effects of competition at the retail level to evaluate whether it is viable in the current market environment, where the State is the primary purchaser of electricity for the investor-owned utilities.

CPUC Action: Corrective action taken.

On September 20, 2001, the CPUC suspended direct access for all new customers. In February 2001 the Department of Water Resources (DWR) began purchasing electricity on behalf of California's utility customers. By suspending direct access, the CPUC acted to stabilize the electric utility customer base and ensure that the DWR did not purchase more power than was necessary.

CALIFORNIA ENERGY COMMISSION

Although External Factors Have Caused Delays in Its Approval of Sites, Its Application Process Is Reasonable

Audit Highlights . . .

Our review of the California Energy Commission's (energy commission) siting and approval process revealed that:

- ☑ *Although the energy commission has not always approved applications within the standard 12-month period, setbacks were due to a combination of factors.*
- ☑ *Of the four states with comparable processes, only Oregon, at 30 months, took longer than California to approve applications. Minnesota, Florida, and Connecticut took between 7 and 15 months to approve applications, while the energy commission averaged nearly 17 months.*
- ☑ *The energy commission is able to approve projects quicker than other permitting processes in California because it combines activities that are performed consecutively under other processes.*
- ☑ *Ten applications have been approved under the new 21-day expedited process, adding over 850 megawatts of electricity to the State's supply.*

REPORT NUMBER 2001-118, AUGUST 2001

The Joint Legislative Audit Committee (audit committee) requested that we examine the application process used by the California Energy Commission (energy commission) for approving new energy generation facilities. Specifically, the audit committee requested, among other things, that we review the appropriateness of procedures and time limits of the application process, the viability of the energy commission's expedited process, and the appropriateness of certifying the application process as equivalent to CEQA. We found that while the energy commission frequently missed the required 12-month deadline for approving applications, the actions of other parties often contributed to the delays.

Additionally, our review of Minnesota, Texas, Florida, Connecticut, and Oregon suggested that, with the exception of Texas, the tasks performed by each state when approving applications were generally similar. Minnesota, Florida, and Connecticut averaged approval times of between 7 and 15 months, Oregon averaged 30 months, and the California energy commission averaged nearly 17 months—2.5 months to assess the adequacy of the application and more than 14 months to approve it. Furthermore, the energy commission's process is more efficient than other equivalent processes available in the State. Specifically, whereas state regulations generally require the energy commission to approve applications within 12 months after deeming them complete, the California Environmental Quality Act and the Permit Streamlining Act allow up to 24 months for the approval of other types of projects that have a similar environmental impact.

Finally, the energy commission expects that 10 projects recently approved under its new 21-day application process will add over 850 megawatts of electricity to the State's supply by the end of September 2001.

Finding #1: The energy commission's approval process has generally taken longer than 12 months.

The energy commission has not always approved applications within the standard 12-month period. For 10 (43 percent) of the 23 applications approved since 1990, the energy commission missed the 12-month standard for approval by more than 30 days. Although the energy commission is ultimately responsible for the approval process, multiple factors contributed to the delays for most of these 10 projects and some of the delays were outside the energy commission's control. For all of the 10 applications that were approved late, applicants did not submit some of the required information in a timely manner. For 7 of these applications, other local, federal, and state agencies failed to process approvals promptly. In addition, outside parties raised objections to some of the proposed sites, thus delaying the approval of 3 applications.

Finally, the energy commission holds public workshops in which it attempts to resolve issues with applications. However, some of the delays caused by public intervention may be the result of the energy commission's failure to enforce its own standards for public workshops and requests for information. The energy commission's regulations generally allow 180 days from the date an application is deemed complete for groups to become intervenors and request additional information. Additionally, the energy commission's internal guidelines establish the same time frame for holding public workshops. However, in some cases since 1990, intervenors submitted data requests, and staff held public workshops, well past the 180-day standard. In fact, for 7 of the 10 applications that were approved late, workshops were held 220 days or more after the energy commission determined that the application was adequate.

The energy commission should exercise its authority to terminate applications when the applicant does not appropriately respond to requests for data. The energy commission should also more strictly enforce its standards that limit the time allowed for intervenors and other agencies to raise new issues and submit data requests to 180 days from the date the energy commission accepts the applications. Finally, the Legislature should consider establishing a firm 180-day deadline for intervenors to raise issues and submit data requests.

Department Action: Partial corrective action taken.

The energy commission states that it recently recommended suspending several projects when the applicants were not timely in submitting data needed for staff to complete their assessments. The energy commission believes suspending projects rather than terminating them reduces the amount of time staff would otherwise spend if an application were terminated then re-filed.

The energy commission also noted that, while a strict 180-day limit for intervenors to raise issues and submit data requests would provide some improvement to related delays, the uniqueness of each project suggests that flexibility is important as provided in the current regulations.

Legislative Action: Unknown.

Finding #2: The energy commission's development of expedited siting procedures may allow for faster approval of applications.

The energy commission developed new 4-month and 21-day expedited processes to bring more power on-line for the summer of 2001. Additionally, to address concerns that construction of new power plants has seriously lagged in the past decade, the energy commission also established a 6-month certification process for thermal power plants that have no adverse environmental impact. It remains too early to determine whether the 6- and 4-month processes will be effective because only one project has been approved under either of these processes. However, the energy commission has approved 11 projects under the 21-day process.

We recommended the energy commission evaluate the effectiveness of the expedited 6- and 4-month processes and determine their long-term viability after an appropriate amount of time has elapsed.

Department Action: Partial corrective action taken.

The energy commission indicates that it has developed a database to track the progress of current 4- and 6-month projects. As each project is completed, the energy commission will update and examine the database to determine if there are any measurable positive aspects that can be attributed

to the implementation of the expedited processes. This information will help the energy commission to determine whether the expedited processes were successful and whether it should recommend to the Legislature that these expedited processes be continued beyond the current sunset dates.

BLACKOUT PREPAREDNESS

The Office of Emergency Services and the California National Guard Each Have Weaknesses in Their Blackout Preparations

REPORT NUMBER 2001-111.1, SEPTEMBER 2001

The Joint Legislative Audit Committee asked us to determine whether the California National Guard (CNG) has a plan to deal with blackouts resulting from the State's energy shortage. Our review also includes an evaluation of the Office of Emergency Services' (OES) plan since it is primarily responsible for assuring the State's readiness to respond to and recover from man-made emergencies such as electrical blackouts. Specifically, we found:

Finding #1: The OES has an alternative power source during a blackout but other concerns about its preparedness exist.

In the event of a blackout, the OES has a generator at its headquarters as an alternative power source. The OES headquarters houses its State Operations Center, which is one of the key locations it uses to receive and process local government's requests for assistance. According to the OES, it runs and inspects the generator on a regular basis, which is a reasonable precautionary step to ensure that this critical facility will have power. However, the OES may have other weaknesses that can affect its blackout preparedness.

In March 2001 the OES distributed to its staff an Energy Shortage Response Matrix (response matrix), which provides background and insight into potential public safety impacts, state actions to date, and its policy relating to energy responses. For example, the OES found that an evaluation of its plans for transferring responsibilities for critical functions to unaffected units and relocating staff to an alternative work site was necessary to refine its Business Continuity Plan (continuity plan). It also recognized the need to evaluate its continuity plan and emergency procedures to ensure back-up systems are operating and whether it could handle a natural disaster during an energy crisis. The OES asserts that it has taken steps to address some of the activities found in the matrix, but we are uncertain if or how it has resolved a few key concerns it raised in its response matrix.

To strengthen its blackout preparedness, the OES should, at a minimum, review and document its efforts to ensure that its relocation and transfer plan, business continuity plan, and emergency procedures address sufficiently the State's energy situation.

➲ ***Department Action: None.***

The OES 60-day response to our recommendations was simply a reiteration of its original audit response letter. The OES states that weaknesses in blackout-specific preparedness activities were already addressed by pre-existing, all-hazard emergency management practices. We disagree. The OES prepared a response matrix in March 2001 and for certain potential public safety impacts, the OES identified additional steps it should take to minimize disruptions to its operations. For example, it recognized the need to evaluate whether it could handle a natural disaster during an energy crisis. Because the OES identified these concerns itself, it seems clear that they were not already addressed by pre-existing practices as the OES is now claiming.

Further, we disagree with OES' belief that its continuity plan and Relocation and Transfer Plan can address a potential blackout situation. In June 2001 the OES identified concerns with its continuity plan and Relocation and Transfer Plan. Moreover, since the OES did not provide us with any evidence such as changes it made or changes that may be pending during the audit or as part of its most recent response, we question whether it has taken the necessary steps to resolve its concerns about its own preparedness.

Finding #2: The OES has taken steps to inform the emergency response community and others about blackouts but some efforts could be stronger.

In addition to preparing itself for blackouts, the OES has worked with the emergency response community to share information about the energy crisis and assist them in planning for blackouts. The OES has also implemented a notification process that provides for a series of alerts prior to a potential blackout. However, the OES lacks a way to evaluate its effectiveness and therefore, may overlook necessary changes or improvements. Finally, the OES developed a guide for local governments in planning for power outages. Although this document addresses many critical planning

issues, the OES may not be able to assist local governments because it has not designated staff to respond to inquiries nor has it trained its staff on how to use the planning document.

We recommended that the OES establish a method to periodically evaluate its notification process, which includes documenting the results of its evaluations and following up with participants to ensure that all necessary changes are made. In addition, the OES should assign specific staff to be responsible for responding to local governments' inquiries about its power outage planning guide. It should also train these staff on how to use the guide and advise local governments on their planning efforts.

➲ ***Department Action: None.***

The OES 60-day response to our recommendations was simply a reiteration of its original audit response letter. The OES states that there is no need for it to specifically evaluate its notification process because the OES uses these same tools for all other types of disasters and emergencies daily. We disagree. In a meeting held on August 14, 2001, the deputy director of Emergency Operations, Planning and Training Division agreed that a formal, periodic assessment of how the notification process is working would be beneficial to identify process improvements. The deputy director also told us that the OES' blackout notification process improved upon its prior notification procedures. For example, it allowed for expanded use of its Emergency Digital Information Service and the incorporation of its Response Information Management System. Therefore, we would expect the OES to ensure that these new enhancements are effective.

The OES stated further that even though there are some issues unique to blackouts, there is no need to designate or train staff to respond to local government's inquiries because these capabilities exist within its structure already. We disagree. Because the OES did not designate and train staff to accept these inquires, there is a potential that when the local governments contact the OES for assistance, they may get passed on to multiple staff and not receive the help they need at all. Moreover, because as the OES states there are issues that are unique to blackouts, despite their technical expertise in overall emergency management operations, staff may not be able to assist the local government in using OES' Electric Power Disruption Toolkit for Local Government.

Finding #3: Although its communication systems are redundant, the CNG's lack of maintenance weakens these systems.

The CNG's outage plan specifies that the armories are to rely on commercial telephone systems as the primary means of communication. If commercial services are unavailable, the plan directs staff to use two alternative communication methods: high frequency radios (HF radios) and cellular phones. Although the CNG's outage plan appears reasonable in that it provides for redundant methods of communication, because the CNG does not ensure that its HF radios and cell phones are intact and operational, it cannot be certain that these alternatives will be available when necessary.

To strengthen its readiness for blackouts, the CNG should develop a plan that sets forth inspection dates for each location with a HF radio, the person responsible for the inspection, and a date certain for the completion of all repairs; and continue with these maintenance checks on an ongoing basis. In addition, the CNG should establish a process to periodically check that each cell phone is operating and the batteries are fully charged.

Department Action: Partial corrective action taken.

The CNG provided us with a maintenance schedule for its 19 HF radios including a party responsible for inspections and an inspection date. The CNG plans to inspect all the radios by March 2002. The CNG also provided information demonstrating that it had made six of its planned visits. However, the CNG still needs to establish completion dates for necessary radio repairs.

The CNG also reported that it is recalling the cell phones it issued to the armories in an effort to reduce its telecommunications expense.

Finding #4: The CNG does not monitor its tactical generators' operability.

The CNG's outage plan specifies that tactical generators may be used in CNG facilities when power is essential for safety, security, and mission requirements. The CNG normally uses tactical generators when staff are in the field and need a power supply for their equipment. Although these generators cannot be connected to the buildings' electrical system to supplant traditional power

sources, they can be used to operate portable light fixtures and radios thereby contributing to the normal operation of a CNG facility during a blackout. However, the CNG does not ensure its facilities periodically test its tactical generators. Therefore, the CNG has limited its assurance that it can use these generators in the event of a blackout.

We recommended that the CNG develop policies and procedures for testing and maintaining its tactical generators and include these policies and procedures in its outage plan. In addition, the CNG should continue to monitor the operational status of these generators.

Department Action: Partial corrective action taken.

The CNG reports that it has amended its Power Outage Plan, which now includes a requirement for field commanders to test their units' tactical generators monthly. The headquarters staff will also review monthly maintenance reports the units submit in order to monitor the generators' operational status.

Finding #5: The CNG does not include in its plan or adequately monitor its headquarters' back-up generators.

The Department of General Services expects state agency and department emergency plans to address how they will ensure that any back-up generator sources are tested and readily available. Although the CNG's plan addresses tactical generators, it does not address the back-up generator in its headquarters building. According to the Director of Plans, Operations and Security, once a week an automatic timer trips and the back-up generator will start up and run for several minutes to ensure the generator is working properly. Because the back-up generator is critical to the CNG's Joint Operations Center during a blackout, we would expect it to include this generator in its plans and to have policies and procedures in place for tracking the weekly generator test and as part of that test, inspecting the generator for sufficient fuel, leaks, or other malfunctions. However, according to the Military Support Civilian Authorities Communications Officer responsible for the headquarters' generator, no such policies or procedures exist; he simply listens for the generator to start up each week.

We recommended that the CNG update its outage plan to address its headquarters' back-up generator that it needs to operate its Joint Operations Center, periodically inspect it for leaks, check its fuel

levels and other critical elements, and execute a maintenance contract to ensure that more extensive inspections occur on an ongoing basis.

Department Action: Partial corrective action taken.

The CNG amended its Power Outage Plan to include weekly tests of its headquarter's back-up generator. In addition, the CNG developed a preventative maintenance inspection checklist to follow when testing the generator. Finally, the CNG provided a description of its scope of work for a commercial contractor to service its generator. The CNG has not let the contract yet as it is trying to determine how the new contract affects an existing warranty.

CALIFORNIA ENERGY MARKETS

Pressures Have Eased, but Cost Risks Remain

REPORT NUMBER 2001-009, DECEMBER 2001

Audit Highlights . . .

The Department of Water Resources (department) faced an immense challenge in purchasing the net-short energy of the three investor-owned utilities. The department entered into 57 long-term contracts for power with an estimated cost of $42.6 billion over the next 10 years. Although the energy crisis has now eased, significant cost and reliability risks remain. Specifically, we determined that:

- ☑ *The speed in which the department entered into contracts in response to the crisis precluded the planning necessary for a power-purchasing program of this size. As a result, it assembled a portfolio of power contracts that presents significant risks that will need careful management to avoid increased costs to consumers.*
- ☑ *The portfolio does not contain sufficient power for peak-demand periods, thus potentially exposing consumers to high market prices if energy supply becomes limited during those periods.*

continued on next page

Assembly Bill 1 of the 2001–02 First Extraordinary Session (AB IX) directed the Bureau of State Audits to conduct a financial and performance audit of the Department of Water Resources' (department) implementation of the Purchase and Sale of Electric Power Program (power-purchasing program). The California energy crisis, which peaked between late 2000 and mid-2001, was unprecedented. Energy prices rose to all-time highs, and blackouts occurred in several instances. The State's three largest investor-owned utilities soon experienced credit problems and had difficulty convincing energy power generators to sell electricity to them.

In response to the crisis, the Legislature authorized the department to purchase the net-short energy for the three largest investor-owned utilities. The net-short energy is the difference between the power that the investor-owned utilities provide and consumer demand, an amount that varies considerably. Through September 2001, the department spent $10.7 billion purchasing the net short. While the department managed to provide the needed electricity, we found it was not prepared for the immense task and is still building its capacity for a power-purchasing program of this size. To reduce the State's dependency on volatile spot market prices, the department entered 57 long-term power contracts at a total value of approximately $42.6 billion over the next 10 years. However, the portfolio of power purchase contracts the department assembled contains cost and legal risks that must continue to be carefully managed, and most contracts do not provide the reliable power intended by AB 1X. Specifically, we found:

Finding #1: The department's contract portfolio contains cost risks that must continue to be carefully managed.

The portfolio that the department has assembled as a response to the crisis emphasizes year-round energy but does not similarly emphasize delivery during peak demand hours. The risk in the portfolio that the department must carefully manage is that the portfolio leaves it exposed to substantial market risk in high peak

- ☑ *The majority of the contracts are not written to ensure a reliable source of power, but instead they convey lucrative financial terms upon the suppliers to ensure that energy is delivered. In addition, the terms of the contracts contain provisions that can increase the cost of power; thus they need careful management to avoid additional costs to the consumers.*
- ☑ *The department lacks the infrastructure needed to properly manage the purchases of the net short, but is taking steps to build up its capabilities.*
- ☑ *Many decisions need to be made about the State's future role in the power market. The department's authority to contract and purchase the net short ends after 2002, yet it or another entity will need to manage the considerable market and legal risks of the power contracts and, if the utilities are not creditworthy, purchase the net short.*
- ☑ *Operational improvements are needed to strengthen the department's administration of the power-purchasing program.*

demand periods if supply shortages occur and to substantial market risk with surplus contract amounts in other hours of the year. Compounding this problem is that many of the contracts are nondispatchable, meaning that the department must pay for the power whether or not it is needed. Further, based on present forecasts from the fourth quarter of 2003 through the first quarter of 2005, the department has procured more power than consumers in Southern California need. Because facilities powered by natural gas produce most of the energy for which the department contracted, the department could also have employed more tolling agreements, which would have allowed the contract price to decrease if gas prices decrease, as is predicted. However, according to the department, before receiving an opinion from the attorney general on February 28, 2001, affirming its authority, the department was not certain that AB 1X authorized it to purchase the natural gas supplies required under tolling agreements. The department is considering various mitigation strategies for these risks and the extent to which the strategies will be successful is unknown at this time.

The department's rush to obtain contracts quickly—it entered about 40 agreements with a value of $35.9 billion in just 30 days—may have played a role in the composition of the portfolio because the department's rush precluded the planning and analysis that are necessary for developing a portfolio of this magnitude. Given the urgency to gain control of power prices and the pace that it chose in reacting to the crisis, the department had little opportunity to conduct the planning that was needed. The choice to move quickly was one of the options that the department could have taken. However, going slower may have resulted in a portfolio with fewer, or less extensive, cost risks to manage.

To effectively plan and manage the economic aspects of its portfolio, we recommended that the department gain a firm understanding of the risks contained in the portfolio. Specifically, the department should conduct within 90 days an in-depth economic assessment of its contracts and the overall supply portfolio that serves customers of the investor-owned utilities. This assessment should occur in conjunction with a legal assessment of the contract portfolio to assure that the department develops an effective overall strategy for contract management. Further, this assessment should focus on how the contracts fit into the overall supply of power and on the contract costs relative to current expectations of market conditions. The department should also establish a planning process that more directly integrates the entire portfolio of supplies serving the customers of the investor-owned utilities with the

contract portfolio. Finally, the department should develop a contract renegotiation strategy that focuses on improving the reliability and the overall performance of the portfolio.

Department Action: Partial corrective action taken.

In response to our audit report, the department states that in September 2001 it began to perform a systematic review of its contracts similar to that recommended by our report. The department further states that it has regularly evaluated the contracts for performance in accordance with the terms, comparison of the contract price to the market price, and accuracy of the invoices. The department states that this evaluation has included a comparison of the portfolio to the projected needs for the net-short energy and ancillary services based on the changing needs of consumers. In addition, the department states that in October 2001, it commenced development of a renegotiation strategy, based in part upon the systematic evaluation of the contracts noted above. Its legal counsel is assessing this evaluation, and associated actions and discussions with the department's counterparties are planned. However, as we noted in our comments on the department's response to the audit, the weaknesses in the department's approach is that it has yet to obtain a fresh set of legal eyes to review these contracts to bring an unbiased perspective to the contract renegotiations.

Finding #2: The department's power purchase contract portfolio may not always provide for the reliable power intended by AB 1X.

Most of the contracts that the department has entered with power generators do not include the terms and conditions that one would expect to see in agreements that ensure the reliable supply of energy. A key goal of AB 1X is for the department to obtain a portfolio of power contracts to supply a reliable source of power at the lowest possible cost so that the State could address the unprecedented financial and supply emergency in its electricity markets. When measuring the adequacy of the terms and conditions of the contracts, we analyzed them to determine whether the contracts assure reliable delivery of power in times of high prices and tight supply.

Our detailed review of 19 transactions, constituting 61 percent of the total gigawatts purchased, and a screening of others concluded that most of the power supplies fall under contracts with terms

and conditions that may not always assure that reliable sources of power will be available to the department. For example, under the terms of most of the contracts, the department cannot terminate the contract or assess penalties even if generators repeatedly or intentionally fail to deliver power at times when the State urgently needs power. Instead, the department can only recover the difference between the contract price and the cost of the replacement power. The right to terminate the agreements when generators repeatedly fail to deliver would have provided the department the leverage to compel generators to deliver power in times of severe need or to replace generators with other, more reliable generators.

The department's contracts also often lack terms and conditions that would better ensure other reliability goals of the contracting effort. For example, they lack provisions that would better ensure that generators are making appropriate progress on building the facilities that will supply the power for which the department has contracted and allowing the department to inspect facilities that the generators say are unable to produce power because of mechanical difficulties. Moreover, the contracts may not always ensure that when the State pays a premium for construction of new generating facilities, the new construction occurs and the generators actually make available and deliver the power produced by the new facilities.

Although the department was in a weak bargaining position because of the financial crisis in the electricity markets, its rush to ease the electricity crisis by locking in power supply through long-term contracts weakened its position even further. In its request for bids, the department did not request contract terms and conditions that are standard in the power industry for entities that must ensure reliable delivery of power. We found that in later contracts sellers agreed to terms and conditions that better assure reliable power delivery. Because the department apparently did not ask for certain reliability terms recognized by the power industry until after it had made the bulk of the deals, we cannot determine whether the department would have been able to obtain more favorable reliability terms in the earlier long-term contracts. We did note that while the terms and conditions improved in the long-term contracts negotiated after March 2001, the department negotiated the vast majority of the power, costing $35.9 billion, before March 2, 2001, during the period in which we found that the terms and conditions regarding reliability of power delivery were least favorable to the State.

Finally, another concern is that the contract costs are not fixed and could rise substantially if the department does not manage its legal risk in anticipation of exposure to potential liabilities and to defaults by energy sellers. For example, the department needs to guard against potential events of default that could expose the State to huge early termination payments. Also, the department needs to protect itself from generator costs that the contracts have shifted to the department. Such costs could include governmental charges, environmental compliance fees, scheduling imbalance penalties, and gas imbalance charges.

We recommended that the department undertake actions to anticipate and manage its legal risk in its contracts. Specifically, to ensure that the department can develop an effective strategy for managing these contracts, it should perform within 90 days in-depth assessments of its legal risk and legal services requirements. Further, to make certain that its legal assessment and representation is on par with those of the other parties participating in the contracts, the department should establish an ongoing legal services function that specializes in power contract management, negotiation, and litigation. When necessary to avoid conflicts, this legal function should be distinct from counsel retained to sell bonds or provide legal advice to the State Water Project. Finally, it should investigate all audit and other rights available to the department under the contracts to assure that it can develop a proper program to enforce the power suppliers' performance.

Department Action: Partial corrective action taken.

The department reports that since September 2001 it has added six additional legal counsel to its team, including three additional internal counsel reassigned from other duties and three outside counsel. These attorneys have the responsibility for evaluation of contract compliance, assessment of the rights of the department under the contracts, and acting as litigation specialists in the event of challenge by counterparties. However, as we noted in our comments on the department's response to the audit, the weaknesses in the department's approach is that it has yet to obtain a fresh set of legal eyes to review these contracts, who would bring an unbiased perspective to the contract evaluation.

Finding #3: The department lacked the infrastructure to carry out the power-purchasing program.

Once the department became responsible for the net short, it began purchasing up to 200,000 megawatts of electricity each day. Through September 2001 the department spent approximately $10.7 billion on transactions for short-term power agreements. However, various factors hampered the department's efforts in its new role, including a dysfunctional market and a lack of infrastructure and experienced, skilled staff. In addition, the department is still developing systems for working with the investor-owned utilities to forecast demand, schedule the least-cost available power, and manage the delivery risks. Consequently, at the same time that the department struggled with purchasing needed power, it also struggled to establish the organization it would need to meet the challenge.

The department also still needs to resolve settlement process problems associated with the energy and ancillary services functions that the department has been conducting and continues to conduct on behalf of the California Independent System Operator (ISO). This resolution is important because under a recent Federal Energy Regulatory Commission (FERC) order, the failure of the department and the ISO to reach agreement on how to facilitate the payment of long-outstanding power obligations may disrupt the future supply of available power in the ISO's short-term markets.

We recommended that the department fully staff the power-purchasing program and consider staffing approaches, including hiring additional consultants and contractors if needed, to assure that personnel shortages do not continue to hinder its operations. In addition, we recommended that the department enhance its skills for market analysis and contract management to properly address the implications of uncertainty on contract portfolio management and power dispatch decisions. The department also needs to develop a transition plan for the orderly transfer of the short-term purchasing and net-short management functions to other entities. Further, it needs to collaborate with the investor-owned utilities to share information about generation sources to ensure the least-cost dispatch of power. As part of this effort, the department should coordinate with the investor-owned utilities and the California Public Utilities Commission (CPUC) to ensure that the rate incentives associated with utility-retained generation scheduling are resolved to support the dispatch of the lowest cost energy. Finally, the department should collaborate with market

participants to resolve settlement process problems associated with the energy and ancillary services functions that the department conducts on behalf of the ISO.

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

The department states it is committed to working with the investor-owned utilities, ISO, and the CPUC to develop the proper incentives for the utilities to dispatch power in a manner which those power resources and the department's contracted supply can be reasonably optimized. The department reports that it began working with market participants to resolve payments related to the settlement process and had reached a tentative agreement with the parties involved. However, these efforts were negated by a November 2001 FERC order that required the ISO to bill the department for the settlement payments. As a result, the department believes it will need to continue working with market participants to resolve this issue. The department's response did not address our recommendations regarding the need for a transition plan for the short-term purchasing function or the need to address its staffing and infrastructure weaknesses.

Finding #4: Many decisions are needed regarding the future role of the State in the power market.

The governor, the Legislature, and the department need to make many decisions about the future role of the State in the power market. Now that the crisis has eased, the Legislature and the governor should consider how best to serve the power requirements of the State's consumers over the long term and how best to manage the costs and mitigate the risks of the power contracts. A plan for the State's future role in the power markets is necessary regardless of whether the department continues to manage the program or whether the program becomes a separate state agency or a different type of governmental entity.

The Legislature will also need to evaluate whether to extend the department's responsibilities beyond January 1, 2003, to allow time for present uncertainties that affect these decisions—such as the financial health of the investor-owned utilities and the role of the new state power authority—to be resolved. Other relevant factors that decision makers must consider include the fact that current long-term contracts do not permit the State to renegotiate or quit contracts that become burdensome or unfavorable and whether the department can assign contracts to other entities. Further, the

Legislature needs to take into account the ability of the administering entity to protect the interests of power programs before regulatory bodies to minimize regulatory risks. Even though the CPUC and FERC do not directly regulate the department, their actions have substantial bearing on the market within which the department operates, the load and services for which the department is responsible, and the collection of revenue. Thus, the department needs to actively manage the regulatory risks that result from CPUC and FERC actions. In addition, the department still needs authority to enter financial transactions to manage gas and electric transaction risks.

We recommended that the Legislature and governor consider developing a comprehensive, long-term strategic framework for the electricity industry in the State and for the department's role in that system. We also recommended that the Legislature consider extending the department's purchasing authority to allow time for the development and implementation of a strategic framework and to assure continuity of the purchasing authority and an effective transition, presumably back to the investor-owned utilities.

Additionally, we recommended that the department develop a strategic plan for the future of the power-purchasing program, including an assessment of the transition processes needed to allow orderly transfer of functions to the ISO, the investor-owned utilities, and others, as appropriate. The department should also continue its efforts to coordinate work with the newly created power authority to clearly establish their respective roles and responsibilities. In its future efforts to protect the interests of the power-purchasing program, the department should retain independent counsel to advise it on matters relating to state and federal regulatory issues. Further, the department should perform a comprehensive assessment of its collaboration with the attorney general, the Electricity Oversight Board, the CPUC, and other state entities to ensure that the interests of the power-purchasing program are distinctly and adequately represented in regulatory proceedings. Finally, we recommended that the department seek clear statutory authority to use financial instruments to manage natural gas and electric gas risks.

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

The department states that it has already commenced a program to assure timely transition of its power-purchasing role to others. It assumes that the investor-owned utilities will resume the obligation to purchase the net short when they become creditworthy, the timing of which is uncertain. The department further states that the CPUC has initiated a proceeding to address the process for returning the role of purchasing the net short to the investor-owned utilities and that it is cooperating with the CPUC staff in this effort. In regards to actively managing regulatory risks, the department reports it already has multiple legal firms providing advice on state and federal regulatory matters. The department agrees that it should gain clear authority to use financial instruments to manage gas and electricity risks and indicates that it is in the process of obtaining legal clarification of the existing statutory authority included in AB 1X from the attorney general. The department's response did not address how it would clarify its and the power authority's roles and responsibilities.

Finding #5: The department needs to improve other capabilities in its administration of the power-purchasing program.

We noted that the department needed to make other improvements in its administration of the power-purchasing program. Specifically, we observed the following:

- Although the department has entered into servicing agreements with the investor-owned utilities, it lacks processes to evaluate their performance in estimating consumer demand for power and the department has not developed procedures for how to exercise its auditing rights or to obtain reports from the investor-owned utilities. In addition, the department and the investor-owned utilities have not agreed to share market data, which would assist the department in carrying out its purchasing function.

- Although the department has taken steps to prevent conflicts of interest among its consultants and has implemented a policy that requires them to file the State's standard form for disclosure of economic interests, its process has not accounted for all consultants working on the power-purchasing program.

- The department's internal controls were not adequate to ensure that all charges to the power-purchasing program were valid. Further, when the department identified errors, it failed to completely correct the errors. For example, we identified approximately 14,300 hours for which department staff worked on the program, but for which no payroll costs were charged to the program. However, the department only corrected charges for approximately 4,300 hours.

To address these concerns, we recommended that the department take the following actions:

- The department should amend the servicing agreements to include language that promotes accuracy in the investor-owned utilities' estimates of consumer power needs. It should also develop audit procedures to monitor the investor-owned utilities' performance of critical elements of the servicing agreements, such as remittance of cash, allocation of the power the department purchases, and the cost of energy conservation programs. The independent auditors of the investor-owned utilities should perform these audit procedures.

- To help ensure that its consultants do not have potential conflicts of interest, the department should continue its efforts to review potential conflicts of interest among all employees and consultants twice each year and retain a record of its review.

- The department should improve its internal controls to ensure that only appropriate costs are charged to the power-purchasing program and that these costs are supported by evidence of service.

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

Regarding conflict of interests, the department indicated during the audit that it had begun another review of its consultants to ensure that those required to file economic interest forms have done so. The department's response to the audit report did not address our recommendations over the servicing agreements with investor-owned utilities or for improving internal controls over charges to the power-purchasing program.