



Implementation of State Auditor's Recommendations

**Audits Released in January 2005
Through December 2006**

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

February 2007
Report No. 2007-406

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CALIFORNIA STATE AUDITOR

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February 28, 2007

2007-406

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

Dear Governor and Legislative Leaders:

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

This information will also be available in nine special reports specifically tailored for each Assembly and Senate budget subcommittee on our Web site at www.bsa.ca.gov. Finally, we notify auditees of the release of these special reports.

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

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

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INTRODUCTION

This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2005 through December 2006. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol  in the left-hand margin of the auditee action to identify areas of concern or issues that we believe an auditee has not adequately addressed.

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

We have compiled the recommendations we directed to the Legislature and have summarized monetary benefits such as cost recoveries, cost savings, or increased revenues that we estimated auditees could realize if they implement our recommendations in two appendices. We estimate that auditees could have realized more than \$953 million of monetary benefits during the period July 1, 2001 through December 31, 2006 if they implemented our recommendations. For example, in our audit of state departments that purchase prescription drugs, we recommended that the Department of General Services (General Services) continue its efforts to obtain more drug prices on contract by working with its contractor to negotiate new and renegotiate existing contracts with certain manufacturers. General Services reported that it implemented a contract with a new prime vendor that it estimates will save the State \$1.3 million annually. Additionally, General Services contracted with a pharmacy benefits manager for the Department of Corrections and Rehabilitation and estimates an additional savings of \$3.8 million annually. Finally, in our audit of state-owned vehicles and garages that General Services operates, with a focus on whether it is cost-effective for the State to own, maintain, and rent its vehicles and own and operate its garages, we recommended that it continue its efforts to obtain lower rates from commercial rental companies by pursuing options for a more competitive contracting process. General Services reported that it pursued a competitive bid process and awarded contracts to one primary and one secondary car rental company. General Services also reported that the contracts it awarded, which are for January 2006 through December 2008, should save the State about \$3 million in each of those three years. During the coming year, we will follow up on General Services' assertions about these two audits, and we will review General Services' changes to determine the extent to which it has implemented our recommendations and is realizing savings.

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

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

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of January 2007.

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

STATE WATER RESOURCES CONTROL BOARD

Its Division of Water Rights Uses Erroneous Data to Calculate Some Annual Fees and Lacks Effective Management Techniques to Ensure That It Processes Water Rights Promptly

Audit Highlights . . .

Our review of the operations of the State Water Resources Control Board's Division of Water Rights (division) revealed the following:

- Because the division's database does not always contain the correct amount of annual diversion authorized, some of the annual fees the division charged over the past two fiscal years were wrong.***
- The division's method of charging annual fees may disproportionately affect holders of multiple water rights that authorize them to divert small amounts of water.***
- Because the division does not factor in certain limitations on permits and licenses, it charges some fee payers based on more water than they are authorized to divert.***
- The number of permits and licenses the division has issued over the past five fiscal years has significantly decreased.***

continued on next page . . .

REPORT NUMBER 2005-113, MARCH 2006

State Water Resources Control Board's response as of September and November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the operations of the Division of Water Rights (division) within the State Water Resources Control Board (water board). Specifically, the audit committee requested that we (1) examine the division's policies and procedures for carrying out its roles and responsibilities, including those for complying with the California Environmental Quality Act and other relevant laws; (2) evaluate the timeliness and effectiveness of the division's processing of applications for new water rights permits and petitions to change existing water rights permits (petitions); (3) determine how the division allocates its resources to fulfill its responsibilities and determine if the division uses those resources to address matters other than the processing of applications and permits—including enforcement, complaint resolution, and board-initiated amendments—of the terms of permits and licenses; (4) identify the extent of any demands placed on the division's resources by other agencies, including the Department of Fish and Game, and by other interested parties that have not filed applications and petitions; (5) determine how the division established its new fee structure and assess its reasonableness and fairness, including the validity of the data the division used when it established its fees; and (6) determine what procedures and mechanisms the division has in place to review the fee structure and modify the fees when necessary. We found that:

Finding #1: The division uses erroneous data to determine some of its annual fees for permits and licenses.

The California Water Code (Water Code), Section 1525, requires the water board to implement a fee-based system so the total amount it collects each year equals the amount necessary to support the program's costs. It specifies that the division is to develop a fee schedule that consists of annual fees and filing fees and also requires the division to review and revise its fees each year to conform to the revenue levels set

☑ *Although the process of approving a water right is complex and can be legitimately time-consuming, the division may cause unnecessary delays because it has a poor process for tracking its pending workload and is sometimes slow to approve documents to be sent to applicants.*

☑ *The data in the division's electronic tracking systems related to applications and petitions are unreliable for the purpose of tracking the progress and status of those files.*

☑ *The electronic bar-code system the division uses to track the location of its files has limited usefulness as a management tool because more than 5,200 of its permit and license files are not present in the system.*

forth in the annual budget act and to make up for undercollection or overcollection of revenues from the previous fiscal year. The division's annual fees for permits, licenses, and certain pending applications consist of a \$100 minimum fee plus a fixed rate per acre-foot (which is about 326,000 gallons) of water authorized for beneficial use in excess of 10 acre-feet. The division assesses other annual fees for petitions, water leases, and certain hydroelectric projects. Holders of riparian water rights, which usually come with ownership of land bordering a water source, or other water rights obtained before 1914 are not under the water board's jurisdiction and are not assessed fees.

The division relies on its Water Rights Information Management System (WRIMS) to calculate the annual fees it charges for permits and licenses. However, we found that the WRIMS data fields that the division uses to calculate the fees did not always contain the correct amount of annual diversion authorized by permits or licenses. Because this information is necessary to calculate annual fees accurately, the fees that the division charged over the past two fiscal years for 18 of the 80 water rights we tested were wrong. Specifically, during this period the division undercharged the holders of 10 of the water rights in our sample by a total of \$125,000, and it overcharged the holders of eight of the water rights by a total of \$1,300. In addition, the division did not bill two water rights a total of \$406 because WRIMS did not list them as active in the system. Furthermore, the division could potentially be setting its rate per acre-foot too high or too low by not having the correct amount of annual authorized diversion for all the permits and licenses in the system.

Contributing to the problem, the invoice the Board of Equalization (Equalization) sends on the division's behalf does not contain sufficient detail for fee payers to recalculate the annual fee. Specifically, critical details of the terms of the permit and license, such as the total annual amount of acre-feet of authorized diversion and the rate the division charges for each acre-foot, are not included. By relying on fee payers to identify billing errors, the division assumes that permit and license holders are able to recalculate their fees based on the terms of their water rights and the division's fee schedule. Furthermore, the largest problems we found related to undercharging rather than overcharging, and fee payers who are undercharged do not have a monetary incentive to report that their bills are too low.

At a cost of \$3.2 million, the water board is seeking to replace the division's current WRIMS with a new system that purportedly will deliver a variety of enhanced features. However, the division must first ensure that its current system contains key data that are accurate and complete, such as the maximum annual diversion amounts that are specified on permits and licenses, before it implements a new system. If it does not ensure the accuracy of its current data, the division is at risk of continuing to assess incorrect annual fees. Further, the division's

new system would not be implemented for more than one year, so ensuring that its current system has accurate and complete data would greatly enhance its ability to bill fee payers accurately before converting to the new system.

We recommended that the division review all the water rights files for those that pay annual fees and update WRIMS to reflect all the necessary details specified on a permit or license, such as the maximum authorized diversion and storage and the applicable seasons and rates of diversion to ensure that its WRIMS contains all the necessary information needed to calculate annual fees accurately for the next billing cycle. We recommended this be completed before the division's conversion to any new database system, so that the data are accurate and complete.

To ensure that fee payers have sufficient information to review the accuracy of their bills, we recommended that the division work with Equalization to include more detail on its invoices, such as listing all the water rights identification numbers or application numbers for which the fee payer is subject to fees, along with the corresponding maximum amount of authorized diversion and the cost per acre-foot. Alternatively, the division could provide this information as a supplement, using its own resources, by sending out a mailer at about the same time that Equalization sends the invoice to fee payers, or by providing the information on its Web site.

Water Board's Action: Partial corrective action taken.

The water board stated that it has developed a plan to update its WRIMS data associated with annual fee calculations. The water board indicated that its plan has seven priority groups of water right records, with a goal of correcting all necessary data before the water board implements its final conversion to its new database system in September 2007. The water board asserts that, as of September 2006, it has reviewed and corrected 880 of the 12,571 water right files and it intends to review another 3,756 by September 7, 2007. However, the water board stated that it believes the marginal returns of completing the work associated with the remaining 7,935 water right files do not warrant redirecting staff to complete those reviews.

The water board also stated that it intends to work with Equalization to include more detail on its invoices and until that time, it intends to provide the recommended information on its Web site. In addition, the water board stated that it intends to send a letter to all of the fee payers providing instructions on how to read the bill and directions to Web site locations for more detailed information.

Finding #2: The division's method for calculating annual fees may disproportionately affect certain holders of multiple water rights.

We also found that the division's method for calculating annual fees may disproportionately affect some fee payers who divert small amounts of water under multiple water rights. The division's approach is to generally distribute the fees among its fee payers in proportion to their overall authorized diversion of water. However, because the division charges a \$100 minimum fee for each individual water right, fee payers who have multiple water rights with small authorized diversion amounts pay proportionately more than those holding a single water right with the same, or in some cases an even greater, amount of diversion. Although we agree that assessing a minimum fee is reasonable, the division could address this issue by charging a single minimum fee for each fee payer rather than for each water right. Our suggested modification to the division's current approach would continue to use existing data sources but would require the division to change the way it sorts the data. In addition, such a change would require a slight increase in the fee rate per acre-foot to offset the reduction in revenues from the minimum fees. Nevertheless, we believe this approach

would more precisely distribute the fees in proportion to the authorized diversion of water. We recognize that there may be a variety of ways to structure valid regulatory fees. Therefore, this change is not required in order for this fee to retain its validity as a regulatory fee.

To more precisely distribute the fees in proportion to the annual fee payers' authorized diversion, we recommended that the division consider revising its emergency regulations to assess each fee payer a single minimum annual fee plus an amount per acre-foot for the total amount of authorized diversion exceeding 10 acre-feet, or other specified threshold.

Water Board's Action: None.

➡ The water board stated that it met with its Fee Stakeholder Group (stakeholder group) on April 11, 2006, to explain and discuss our recommendation. The water board stated that to date, there has been no support for the recommended change from members of the stakeholder group.

Finding #3: Some fee payers are charged based on more water than they are authorized to divert.

Some fee payers hold multiple water rights that include a term limiting their combined authorized diversion to an amount that is less than the total diversion authorized for their individual rights. Their annual fees are calculated in a manner that is inconsistent with the calculation of annual fees for fee payers who hold a single water right that includes a term limiting the authorized diversion.

The California Code of Regulations, Title 23, Section 1066(b)(3), states that if a person or entity holds multiple water rights that contain an annual diversion limitation that is applicable to a combination of those rights, but may still divert the full amount authorized under a particular right, the fee shall be based on the total annual amount for that individual right. For example, a person may hold five water rights, each with a face value of 200 acre-feet, for a total of 1,000 acre-feet, but the overall authorized diversion on those five water rights may be limited by one of the rights to 800 acre-feet. The division implements the regulation just described by charging holders of multiple water rights annual fees based on the face value of each permit or license and does not take into account the overall limitation on authorized diversion. Consequently, the fee charged to the holder of these five water rights would be based on 1,000 acre-feet rather than the 800 acre-feet the fee payer actually is authorized to divert. The division does take a diversion limitation into account when it is a specific term on a single permit or license. Although the division has considerable discretion in interpreting its regulations, we find this inconsistency in the treatment of single and multiple water rights holders particularly noteworthy, given that the division may bring an enforcement action against a water right holder who violates the terms and conditions of a permit or license by exceeding the annual use limitation applicable to combined water rights. Consequently, the holder of multiple water rights may be required to pay an annual fee for an amount of water that, if actually diverted, could subject the holder to an enforcement action.

We recommended that the division revise its emergency regulations to assess annual fees consistently to all fee payers with diversion limitations, including those with combined limitations, so fee payers are not assessed based on more water than their permits and licenses authorize them to divert.

Water Board's Action: None.

➡ The water board stated that it met with its stakeholder group on April 11, 2006, to explain and discuss our recommendation. The water board stated that to date, there has been no support for the recommended change from members of the stakeholder group. The water board stated that this

is because the water board and its stakeholder group were unable to determine the effect of this recommended change on each stakeholder's fee without a manual review and calculation of the fees for a significant number of water rights.

Finding #4: The division has weaknesses in its process of tracking applications and petitions.

The division does not have an effective method of tracking its pending workload. The division has two independent electronic systems designed to track information pertaining to pending applications: the application tracking system, which tracks general information relating to an application; and the environmental tracking system, which tracks information more specific to the application's environmental review process. The division uses another system to track information pertaining to pending petitions. Our review of these systems found the information to be unreliable because the division failed to ensure that the systems contain accurate and complete data necessary to track pending workload. As a result, the division cannot rely on these systems as an effective management tool to track the progress and status of its pending workload, which may contribute to delays in processing applications and petitions.

Of the 615 pending applications in the division's application tracking system, 41 percent were assigned to supervisors who no longer are employed by the division and 44 percent did not have any staff assigned to them. Furthermore, we found that the "next step date" field in the application tracking system, used to track upcoming stages of the application process, such as the dates the division expects to send public noticing instructions or issue a permit, was not always updated or was blank. The division identified future action for fewer than 30 applications. The remaining applications indicated activity that was long past due, and 189 applications did not have any "next step date." Therefore, the application tracking system is incomplete and inaccurate for the purpose of tracking the progress and status of applications. The division's environmental tracking system is unreliable as well because it too is incomplete and inaccurate for the purpose of tracking applications. For example, 74 percent of the applications in the environmental tracking system did not have any staff assigned to them, and 85 percent of the applications did not contain any data in the "activity target date" field, which could be used to identify when the division is supposed to complete a certain activity. When a tracking system does not accurately reflect the staff assigned to process an application, it cannot be used to monitor staff progress or to ensure that workload is distributed in a manner that facilitates efficient and timely processing. Moreover, a tracking system that lacks reliable dates cannot be used to determine workload status or to monitor processing times.

Similar to the division's application and environmental tracking systems, we found that its petition tracking system does not contain accurate or complete data in some fields necessary for effective management. Specifically, of the 530 active petitions in the petition tracking system as of December 2005, 44 petitions did not show what action has been taken, 65 petitions did not include the date that the last action occurred, and 219 petitions did not include information regarding which staff members were assigned. In addition to finding that critical information was missing, we found inaccuracies in some of the populated fields. Namely, for three of the six petitions we examined, the information regarding the last action taken by staff and when that action occurred was incorrect.

We recommended that the division ensure that its tracking systems for pending applications and petitions are complete and accurate by reviewing its pending workload and updating the systems to reflect current information before it upgrades to a new system. The division also should strengthen its procedures to ensure that staff maintain the accuracy of the data in the systems.

Water Board's Action: Pending.

The water board stated that to ensure the applications, petitions, and environmental tracking systems are complete and accurate, it is in the process of reviewing each of these tracking databases. It further stated that the information is being updated by designated staff and will be reviewed by the division's management for accuracy. The water board also stated that it has implemented procedures to ensure staff maintains the accuracy of the tracking systems.

Finding #5: Unexplained delays exist between various phases of water rights processing.

In our sample of 15 recently issued permits and licenses, we found significant and sometimes unexplained delays between various phases of the water rights application process. The California Code of Regulations (regulations) requires the division to review permit applications for compliance with the requirements of the Water Code and the regulations. The regulations also specify that an application will be accepted for filing when it substantially complies with the requirements, meaning the application is made in a good faith attempt to conform to the rules and regulations of the water board and the law. Generally, the Water Code does not specify the length of time in days within which the division must complete each step of processing an application. In November 2003, the division directed staff to accept permit applications in one working day. However, we question whether this goal is realistic because the division would not have met it for any of the 12 permits and licenses for which we could determine the number of days. Specifically, in 11 of the 12 cases, the division took 29 to 622 days to accept the applications. Moreover, the division stated that its goal is to send noticing instructions to applicants within 30 days after it accepts an application. However, it did not meet this goal for 14 of the 15 recently issued permits and licenses we tested.

Contributing to some of the delays in the water rights application process was the time taken by the division's management to approve and issue some of the documents it sent to applicants. In one example, the division took 85 days to approve a permit and cover letter, and it did not send them for an additional 56 days. The permitting section chief stated that it took about three months to review the file to ensure technical accuracy, but he did not know why it took 56 days to mail the final permit after the chief approved the letter. In another example, the division issued a permit cover letter to an applicant 60 days after it approved the letter for issuance. According to the permitting section chief, this delay occurred because the division's file room had a backlog of assignments. However, we are uncertain why a backlog of assignments would delay for 60 days the issuance of a letter that was ready for mailing.

We recommended that the division consider establishing more realistic goals that are measurable in days between the various stages of processing an application and implement procedures to ensure that staff adhere to these goals. In addition, the division should develop procedures for improving the timeliness of management review and issuance of documents.

Water Board's Action: Pending.

The water board stated that it has a number of efforts underway to address this recommendation, such as reviewing its business practices to identify needed improvements, updating the procedures manual, revising route slips, and revising templates, as appropriate. Further, the water board stated that the chief of the division (division chief) directed all of the division's staff to identify where the "log jams" occur in processing. The program managers have been tasked to set a realistic goal measurable in days to complete each step in each process. Furthermore, the water board stated that the division chief has started a review of current delegations to determine if certain actions that are currently performed by division management should instead be delegated to lower level staff.

Finding #6: Weak file tracking causes inefficiency.

The division does not effectively track water rights files, causing its staff to spend valuable time searching for files when they could be involved in more productive activities. The division uses an electronic bar-code scanning system to track the location of several types of water rights files. The files scanned into the system as of September 2005 generally were related to permits, licenses, and small domestic use registrations. Ideally, scanning allows the division to identify the location of the file and the individual who possesses it. However, when we compared the data in the bar-code system to application numbers that were billed in fiscal year 2005–06, we found that more than 5,200 permit and license files did not appear to have been scanned into the division’s bar-code system. We selected a random sample of 30 of these files to determine whether they in fact had a bar-code label and to see if we could readily locate the files in the division’s records room. From this sample, we found 28 of the files in the records room and each file had a bar-code label. One of the remaining two files was in the records room, but it did not have a bar-code label. We could not locate the last file, and since it was not in the bar-code system we could not determine its location using the system. Thus, the division’s bar-code system as currently implemented is not as effective a management tool as it could be for tracking the location of its files.

Moreover, we found that the bar-code system does not have the necessary controls over data entry, resulting in invalid entries in the system. The system is designed to capture an employee’s name and the file number that the employee is trying to scan. However, some scanning errors can occur if an employee scans a file number before scanning his or her name, or if the employee simply scans a file number too quickly, which results in the system capturing the file number more than once in the same field. The system does not have controls to reject these incorrect entries. For example, we queried the list of files that had been checked out to a staff member and found instances where there were employee names in the application number field for several files and multiple application numbers in a single entry.

We recommended that the division continue to work with the water board’s Office of Information Technology to improve the controls over data entry in its bar-code system. We also recommended that the division conduct a complete physical inventory of its files and ensure that each file has a bar-code label and is scanned into the system.

Water Board’s Action: Pending.

The water board stated that it plans to replace the existing bar coding system with a wireless bar coding feature in the data system currently under development. In addition, the water board stated that its Office of Information Technology will ensure that proper controls are in place to provide quality assurance in the data. The water board stated that, in the meantime, it has informed staff of common scanning problems and will provide training to its staff. Moreover, the water board stated that it has developed a workplan and procedure to check for the presence of bar codes on all files and to scan files into the system that are not currently scanned. However, it will not begin this work until it has made sufficient progress in its review and correction of water rights data in its database.

MILITARY DEPARTMENT

It Has Had Problems With Inadequate Personnel Management and Improper Organizational Structure and Has Not Met Recruiting and Facility Maintenance Requirements

Audit Highlights . . .

Our review of the California Military Department (department) revealed that:

- It has not effectively reviewed its state active duty positions, and as a result may be paying more for some positions than if they were converted to state civil service or federal position classifications.***
- It has convened a panel to review the propriety of its 210 state active duty positions and estimates it will take three to five years to implement the panel's recommendations.***
- It did not follow its regulations when it temporarily appointed many state active duty members to positions that do not appear to be temporary, failed to advertise some vacant positions as required, and inappropriately granted an indefinite appointment to one state active duty member after he reached the mandatory retirement age.***

continued on next page . . .

REPORT NUMBER 2005-136, JUNE 2006

California Military Department's response as of December 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Military Department's (department) resource management and recruitment and retention practices. Specifically, the audit committee asked that we review the department's operations and practices regarding strategic planning, the use of state and federal funds and personnel, the current condition of its armories, its management of state military personnel, recruitment and retention practices, and reporting of military personnel's attendance at training to maintain their military skills.

The department is responsible for the command, leadership, and management of the California National Guard (Guard), including its army and air force components, and related programs, such as the State Military Reserve and the Guard's youth programs. The Guard provides military service to California and the nation and serves a threefold mission: as a reserve component of the U.S. Army and Air Force, the Guard provides mission-ready forces to the federal government, as directed by the president; it supports the public safety efforts of civil authorities during emergencies, as directed by the governor; and it provides military support to communities, as approved by the proper authorities. The state adjutant general, who is appointed by the governor and confirmed by the state Senate, serves as director of the department and commander of the Guard.

Finding #1: The department has not effectively reviewed its state active duty positions, as required by its regulations, to determine whether those positions could be filled with state civil service employees.

The Military and Veterans Code grants the governor the authority to activate or appoint part-time Guard members to full-time duty, known as state active duty. The department's regulations require that the department review its state active duty positions periodically to determine whether they would be more appropriately classified as state civil service positions or federally funded positions. These state active duty positions are staffed

- ☑ *It is deficient in its management of federal employees by using them in positions and for duties that are not federally authorized.*
- ☑ *State active duty members who become whistleblowers do not have access to an independent authority to resolve complaints of alleged retaliation.*
- ☑ *Although the department's strategic planning process was interrupted by the events following September 11, 2001, and ultimately abandoned by the former adjutant general, the department has recently revived the process.*
- ☑ *In establishing new headquarters' divisions and an intelligence unit, the former adjutant general failed to obtain state approval.*
- ☑ *The department used federal troop commands and counterdrug program funds for unauthorized purposes when it formed a field command for operations to support civil authorities and established additional weapons of mass destruction response teams.*
- ☑ *The department was unable to demonstrate that it ensured all misused counterdrug funds were reimbursed from other federal sources.*
- ☑ *In recent years, the Army National Guard and the Air Guard did not meet their respective goals for force strength.*

with military personnel who receive federal military pay and allowances that in some cases greatly exceed the costs to employ state civil service employees. For example, a colonel responsible for records management, printing, mail services, and supplies management receives an annual salary of about \$125,500, while a civil service counterpart in another state department with similar responsibilities receives an annual salary of \$62,300. The department's adjutant general has convened the State Active Duty Reform Panel (panel) to review the department's use of state active duty members. The panel's tasks include reviewing the state active duty positions to determine if the responsibilities of those positions could be performed by other state or federal position classifications available to the department. The panel is also addressing other past personnel practices of the department, such as creating more state active duty positions than the budget authorized. The department estimates it will take three to five years to implement any changes the panel recommends.

To reform its use of state active duty personnel and comply with its senior leadership's wishes for how they should be used, we recommended the department ensure that the panel completes the tasks assigned to it by the adjutant general and follows through with the panel's recommendations.

Department's Action: Partial corrective action taken.

The department reports that it has reviewed all of the 210 baseline state active duty positions and additional positions, such as temporary positions and positions already under transition to nonstate active duty status. The department states that the actions it has completed regarding the positions it reviewed include developing or modifying position descriptions, reclassifying positions when appropriate, considering downgrading or eliminating positions, and advertising those positions identified for transition from state active duty to either state civil service or federal technician.

The department further reports that although it has not completed its plan to convert positions targeted for transition from state active duty to other status, it has begun converting those positions. For example, the department reports that it has converted every targeted position that has become vacant through normal personnel actions. As of December 2006 the department has converted 10 of 60 targeted positions and the remaining positions will be converted when they become vacant through reassignment, retirement, or resignation. The department estimates it will take an additional 24-36 months to convert the remaining targeted state active duty positions.

- ☑ *The department does not maintain adequate procedures to demonstrate it accurately reports training attendance or monitors and addresses Guard members with excessive absences.*
 - ☑ *The State Military Reserve has not met its force strength goals in recent years; and the department has not identified the role for the State Military Reserve, allowing it to identify its force strength needs.*
 - ☑ *Ninety-five of the department's 109 armories are in need of repair or improvement, contributing to a \$32 million backlog.*
 - ☑ *The department's allocations of state and federal funding, including a relatively small amount of money from the Armory Fund, have not been adequate to maintain the armories.*
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Finding #2: The department engaged in questionable practices related to its state active duty workforce.

The department temporarily appointed numerous state active duty members to positions that do not appear to be temporary in nature. In many cases, the department repeatedly extended temporary appointments for set periods—usually one year—that in effect converted them into appointments of indefinite duration. The department's regulations define temporary appointments as those with specified end dates. Further, the department has not always followed its requirement of announcing a vacant state active duty position before filling it. Announcing vacant positions allows qualified individuals to compete for the positions.

Also, the department did not follow state law and its regulations when, in September 2001, it granted an indefinite appointment to a state active duty employee who had reached the mandatory retirement age. State law sets the mandatory retirement age for state active duty members at 60. For an employee to remain in a state active duty position beyond age 60, he or she must obtain approval from the adjutant general and then can hold only a temporary position. The adjutant general has directed the panel to review the department's hiring policies and practices for the state active duty program and suggest necessary changes to the department's regulations to conform to the Military and Veterans Code.

We recommended the department review its hiring policy and practices for state active duty members, as directed by the adjutant general, and make the necessary changes in its policy and regulations to provide adequate guidance to its commanders and directors.

Department's Action: Pending.

The department reports that although it originally planned to implement this recommendation by October 2006, it has since concluded that updating the department's policies and regulations was not a task suitable for the panel and has decided to form a separate team to accomplish the task. The adjutant general will appoint the team in January 2007 and expects the team's task to be completed during the first quarter of calendar year 2007.

Finding #3: The department's overall management of its federal employees is deficient.

The National Guard Bureau pays for the federal full-time military members and civilian employees the department uses to support the department's large part-time force. Yet the department does not always use those federal personnel in the positions and for the duties authorized by the National Guard Bureau. For example, the department's analysis identified at least 25 full-time active guard reserve members in the joint force

headquarters working in unauthorized positions as of January 26, 2006. As of March 1, 2006, the State was authorized to have 48 active guard reserve personnel in its joint force headquarters, yet 76 were actually assigned and working there, leaving other Guard units short staffed.

According to the chief of staff of the Joint Staff and the chief of staff of the Army Guard, numerous factors explain why the department has exercised poor control over its full-time staff. These factors include undocumented movement of personnel over a long period under the command of many past adjutants general, the department's use of outdated authorizing documents, and confusion over whether the Joint Staff or the Army Guard is responsible for issuing orders for full-time personnel.

We recommended the department develop and implement procedures to ensure that it complies with authorizations for federal full-time military personnel to support its part-time Guard forces. Those procedures should include designating the responsibility for issuing orders for full-time personnel to a single entity.

Department's Action: Partial corrective action taken.

The department states that it has always complied with overall authorizations for full-time manning and points out it believes that the issue was to what extent the department had authority to move allocations between units. The department points out that the adjutant general has the authority to assign full-time active guard reserve members to any unit or organization necessary to accomplish federal and state missions. However, the department also points out that this authority does not eliminate its requirement to consider the allocation rules used by the National Guard Bureau to provide these resources to the State, and to the extent possible, assign these resources in accordance with unit by unit allocations.

Nonetheless, the department states it has reviewed its allocations of authorized federal full-time personnel and mission requirements with the intent to more closely align staff assignments with position authorizations. As a result, the department reports it has reassigned 35 percent of the full-time active guard reserve members that were previously assigned to the joint forces headquarters. Further, the department states that ongoing management of its mission requirements and future resource allocations will, to the maximum extent practicable, minimize the future disparities between resource allocations and assignments.

Finally, the department reports that it has assigned the responsibilities for issuing orders for full-time members solely to the active guard and reserve branch within the joint forces headquarters.

Finding #4: We could not confirm that the department disseminates information on benefits to deploying Guard members.

Although regulations and department procedures require the department to inform all members who are called to active duty and deployed for service of the benefits available to them as active members of the Guard, the department could not provide evidence that it had done so. Nevertheless, nothing came to our attention that led us to believe these members did not receive benefits briefings. Among the benefits included are medical, dental, life, and unemployment insurance and reemployment rights. The department provided descriptions and handbooks containing evidence that it has processes that offer multiple opportunities to inform deploying Guard members and their families of the benefits available to them during members' active duty status. However, the department's checklists and others records are not sufficient to allow us to confirm who has received these benefits briefings, and the records are not kept for all deploying Guard members. Because the department does not retain written evidence of who has received a briefing, we could not confirm that Guard members are aware of their benefits.

Because the department has a responsibility under federal regulations to inform deploying members of the benefits available to them while on active duty, we recommended the department consider implementing a procedure for both the Army Guard and the Air Guard to demonstrate that it complies with that requirement.

Department's Action: Corrective action taken.

The department reports that subsequent to the release of our audit report, it conducted a review of the processes used during pre-mobilization activities and completed discussions with the federal oversight authorities responsible for oversight and approval of the department's pre-mobilization activities and actions. Although the department concluded it complies with federal requirements for the pre-mobilization processing, it acknowledged that additional opportunities exist to document its compliance. The department states its review and actions will improve its ability to document the actions taken during pre-mobilization activities.

Finding #5: State active duty members do not have access to an independent process to resolve complaints of retaliation against whistleblowers.

In contrast to legal protections for federal employees who act as whistleblowers, state active duty members who become whistleblowers do not have access to an independent authority to resolve complaints regarding retaliation. Rather, department regulations require that state active duty personnel attempt to resolve their complaints through the lowest level of supervision or state active duty chain of command before filing an official complaint with the department's State Personnel Office. As a result, a state active duty member lodging a complaint of retaliation is forced to first lodge a grievance with the same commander who allegedly engaged in retaliation.

To ensure that its state active duty personnel can report any alleged violations of statutes, regulations, or rules without fear of retaliation, we recommended the department establish a process independent of the chain of command to protect those state active duty personnel who wish to file complaints alleging retaliation by a superior.

Department's Action: Pending.

The adjutant general supports providing state active duty personnel the ability to register legitimate complaints without fear of retribution by superiors. In addition, the department states that because it does not have the authority to establish an independent process, it is prepared to work closely with state authorities to create an independent state inspector general.

Finding #6: The department does not adequately maintain files to demonstrate that it complies with regulations concerning allowable activities.

Reviews and recommendations regarding legal or ethical conduct are supplied by the Staff Judge Advocate's Office using Standards of Ethical Conduct (ethics standards) issued by the Department of Defense. Because the Staff Judge Advocate's Office does not keep logs of the requests for outside activities it reviews or records of the recommendations it provides to leadership, it cannot demonstrate, nor can we confirm, that the department consistently follows the guidance contained in the ethics standards.

We recommended that in order to demonstrate the department complies with the ethics standards, the Staff Judge Advocate's Office implement a system to log the activities it reviews and to maintain files of the opinions it provides to department leadership on questions of compliance with those ethics standards.

Department's Action: Corrective action taken.

The department reports that the Staff Judge Advocate's Office has established a procedure to maintain duplicate files of ethics opinions: one file of opinions by the individuals' name or the name of the operation, and one in a central file.

Finding #7: The department's lack of an adequate strategic planning process contributed to its questionable reorganizations.

The Guard's strategic planning process was interrupted after the events of 9/11 and was subsequently abandoned altogether by the former adjutant general. Without a current strategic plan and a formal strategic planning process for identifying and analyzing threats and opportunities, the department cannot measure how well it is accomplishing its federal and state missions. In the absence of a properly prepared strategic plan, the former adjutant general chose to place a greater emphasis on providing military support to civil authorities. In doing so, he sponsored the creation of unauthorized entities, such as the Civil Support Division in its headquarters and an expanded intelligence unit within it, and a field brigade, known as the MACA Brigade, to command military support to civil authorities. However, because the department at that time did not have a strategic planning process that would have justified the need for those entities, we cannot conclude that the former adjutant general's change in emphasis was warranted. Although the department recently took steps to again implement a strategic planning process, had it adhered to the principles of strategic planning in the past, many of the problems associated with the former adjutant general's organizational changes might have been avoided.

In its efforts to implement the former adjutant general's perception of the organizational mission, the department violated state and federal laws and regulations. First, the department established the new organizational entities without obtaining state and federal approval. For example, the department did not obtain the required approval from the state Department of Finance to establish the new entities within its headquarters. Second, the department used federal troop command units for purposes not authorized by the federal National Guard Bureau when it combined the resources assigned to the units and formed a field command headquarters to support civil authorities.

We recommended that in order to avoid public concern and promote transparency and to comply with state and federal laws, regulations, and administrative policies, the department continue its efforts to reimplement a strategic planning process. This process should include the in-depth analyses of the threats and opportunities facing the department, including changes in the environment and leadership. In addition, the department should obtain appropriate approvals from the state Department of Finance and the federal National Guard Bureau before making organizational changes in the future.

Department's Action: Partial corrective action taken.

The department reports that it has continued its reimplementation of a strategic planning process that involves input from staff—a process it says continues to mature. The department reports it continues to track organizational and operational goals to ensure allocation of resources and efforts on priority issues related to the strategic plan. Management's current focus requires that the status of every goal be reported to management on a monthly basis. In addition, the department states that it continues to refine and update its strategic plan, and anticipates initiating its first annual update of its strategic plan with an executive off-site meeting scheduled for April 2007.

Further, the department reports that it has confirmed with the National Guard Bureau that its current efforts to complete reorganizations are in agreement with the policies, procedures, and guidelines provided by the National Guard Bureau. The department also states that it has coordinated current organizational changes with the Department of Finance and has received approval for the current organizational configuration and is conducting discussions with the Department of Finance to ensure the department gains approval prior to any future organizational changes.

Finding #8: The department inappropriately used federal counterdrug program funds to command the MACA Brigade and establish its terrorist response capabilities.

The department directed the use of resources from the federal counterdrug program to operate the field command headquarters and to establish weapons of mass destruction response teams beyond what was federally authorized and funded. We believe this misuse of resources violated federal counterdrug laws and regulations. In addition, the department could not prove that it ensured that all the misused funds were reimbursed from other federal sources. Although we were able to confirm that most of the \$783,000 in misused counterdrug program funds were reimbursed, the U.S. Property and Fiscal Officer (U.S. fiscal officer)—the federal agent of the National Guard Bureau that handles the federal property and federal funds for the California’s Army Guard and Air Guard—was unable to provide evidence that action was taken to reimburse more than \$85,500 for Army Guard and Air Guard personnel pay and allowances and equipment costs.

To ensure that all federal counterdrug program funds used for non-counterdrug activities are properly reimbursed, the department should work with the U.S. fiscal officer to identify all the non-counterdrug costs that have yet to be reimbursed and to ensure that the transfer of costs from the appropriate accounts occurs. In the future, the department should not use counterdrug program funds for non-counterdrug activities.

Department’s Action: Partial corrective action taken.

The department reports that the U.S. fiscal officer has determined that no further reimbursement would be appropriate for \$66,000 of the \$85,500 amount we identified in our report. According to the department, the U.S. fiscal officer based his decision on his opinion that the amount was either offset by previous reimbursements or cannot be validated as costs charged to the counterdrug program. Reimbursement of the remaining amount will require a transaction at the National Guard Bureau level and the U.S. fiscal officer is working with Air National Guard Financial Management to enact the reimbursement to the counterdrug program.

Further, the department states its leadership, in conjunction with the U.S. fiscal officer, has reviewed the restrictions for the use of counterdrug program funds and will not use these funds for noncounterdrug program purposes without prior approval from the National Guard Bureau. Also, the department stated it is in the process of establishing an internal control program that will have the capability to review and audit financial transactions and cost allocations to ensure they conform with federal and state guidelines.

Finding #9: The department has not met recent force strength goals.

Although California’s Army Guard met its goal for federal fiscal year 2003, its performance in meeting its goals for federal fiscal years 2004 and 2005 declined. According to the Army Guard, maintaining prescribed force levels has become increasingly difficult because of several factors, including a perceived lack of state incentives. However, if the department does not meet its force strength targets, the

National Guard Bureau may redistribute federal resources to states that do meet their targets—resources the department needs to achieve its state mission of providing military assistance to California’s civil authorities in times of insurgence or catastrophic events.

Like the Army Guard, the Air Guard has not met its force strength targets, and its performance in meeting those targets has slipped over the past three years. Although the Air Guard achieved 93 percent of its force strength goal in federal fiscal year 2005, it ranked 38th among the 54 jurisdictions (states, territories, and the District of Columbia). The Air Guard attributes its diminished ability to meet force strength goals to the fact that goals are consciously set high to achieve optimum force strength, the ongoing war, and a smaller pool of personnel with prior service to recruit from.

We recommended that the department identify and pursue the steps necessary to meet the force strength goals set by the National Guard Bureau, including but not limited to identifying the most effective manner to use the additional recruiting resources provided by the National Guard Bureau and continuing to pursue, through the State’s legislative process, incentives it believes will encourage citizens to join the Guard.

Department’s Action: Partial corrective action taken.

The department states that its actions have resulted in the Guard meeting or exceeding its national targets for both new recruits and overall end strength for the federal fiscal year ending September 30, 2006. The department expects to sustain its success in maintaining overall force strength through the newly released recruiting initiative called the Guard Recruiter Assistance Program. Under this program, Army and Air guardsmen are encouraged to recruit for their respective units through a \$2,000 cash payment for each new member they recruit.

Further, the department points out that the federal government provides incentives to help maintain force strength, such as \$20,000 bonuses for enlistment and re-enlistment and \$20,000 for student loan repayments and education assistance. However, the department states that additional incentives from the State, such as tuition assistance, health care, state income tax exemption, life insurance tax credit for deployed soldiers, and a cash referral incentive, could considerably assist it in meeting recruiting and retention goals.

Finding #10: The department needs to improve its procedures for monitoring training attendance.

Because we found discrepancies in the attendance data reported by the Army Guard units and not all of the units we contacted provided the information we requested, we could not verify the accuracy of the reported attendance for 22 of the 25 Army Guard units we reviewed. Further, Air Guard headquarters does not monitor training attendance; rather, it relies on the units to accurately report attendance.

In addition, neither the Army Guard nor the Air Guard fully responded to our requests for evidence of actions taken for members with excessive unexcused absences from training. By retaining on its rosters members who do not meet their training obligations, the Guard could report an inflated number of members adequately trained and prepared to meet its missions. Using a January 2006 report provided by the National Guard Bureau, we identified 250 Army Guard members who had not attended training for at least three months. According to the chief of staff of the Army Guard, it strives to meet the National Guard Bureau’s standard of keeping the proportion of members on this report below 2 percent of the total roster, which it met as of January 2006. According to the personnel officer of the Air Guard headquarters, prolonged or numerous absences are a cause of concern. However, ensuring the capability of a unit to meet its mission, including preparedness through training, and accomplishment

of its mission are the responsibility of the unit commander. Commanders can use their discretion in evaluating an absent member's potential for useful service and can attempt to bring him or her back into compliance with training requirements.

We recommended that the department enhance or develop and implement procedures to monitor training attendance by its Guard members to ensure that it can verify the accuracy of reported training attendance. It should also ensure that it does not retain on its rosters members who qualify as unsatisfactory participants because they are not meeting their training obligations. Finally, the Air Guard should consider some level of oversight of the handling of members with excessive unexcused absences.

Department's Action: Corrective action taken.

The department states that both the Army and Air Guard have instituted additional measures to retain documentation that can serve to verify the accuracy of attendance reports. At headquarters, the Air Guard recently instituted a requirement that each wing provide a monthly report of members with unsatisfactory participation in training activities. These reports demonstrate the action taken on individuals with unexcused absences. The department reports that during a recent meeting with wing commanders, the commander of the Air Guard reiterated the importance of taking timely action to either return wayward members to duty or impose appropriate disciplinary measures, ranging from stern notification memorandums to demotion or involuntary separation for cause.

In addition, the department states that the Army Guard headquarters will continue to monitor local unit attendance reports and will institute corrective action for units that fail to meet the national federal standard for accurately reporting attendance.

Finding #11: The department's State Military Reserve has not met its force strength goals.

The State Military Reserve—a corps of volunteers, most with military experience, who support the Guard—also has not met its force strength goals in recent years. For calendar years 2003 through 2005, the State Military Reserve achieved only 56 percent to 65 percent of its goals. However, the department had not provided adequate guidance to the State Military Reserve regarding the department's mission for the State Military Reserve to allow it to determine its needed force strength. The State Military Reserve performs various services for the Guard, such as training, helping with mobilization, and assisting civilian authorities. Although the department appears to value the State Military Reserve's help in fulfilling the Guard's mission, as of April 2006 the department had not yet formally identified the specific role and responsibilities of the State Military Reserve within its draft strategic plan. The department's draft strategic plan calls for finalizing the plans for how the State Military Reserve can best support the needs of the Guard and the department by the end of 2006.

We recommended the department include the State Military Reserve in its current strategic planning process and ensure that it defines the State Military Reserve's role and responsibilities so as to maximize the support it provides to the Guard. Once its role and responsibilities are identified, the State Military Reserve should target its recruiting goals and efforts accordingly.

Department's Action: Partial corrective action taken.

The department reports that the State Military Reserve was included as a full partner in the department's strategic planning process, during which it collaboratively identified its vision, mission, core competencies, and priority issues. In addition, the State Military Reserve has developed action plans to implement its priorities and the department is updating the manning

document for the State Military Reserve, which will further integrate it into the overall organization of the department and facilitate a focused recruiting program to align potential recruits with vacancies. The department anticipates completing the updated manning roster and recruiting action plans before April 1, 2007.

Finding #12: The department's armories are in poor condition and the department has identified \$32 million in unfunded maintenance needs.

Of the department's 109 armories, 95 (about 87 percent) are in need of repair and improvement. As of March 2006, the department had identified about \$32 million in backlogged repairs, maintenance, and improvements it could not fund. Funding to maintain the armories is provided primarily through appropriations from the State's General Fund and matching funds through cooperative agreements with the federal government. Some additional funding comes from the Armory Fund and the Armory Discretionary Improvement Account through the sale or lease of unneeded armories and the receipts from renting armories when not in use, but those amounts are minor compared with the armories' overall needs. Moreover, as a result of a ballot initiative passed by the voters in 2004, most Armory Fund revenue will be used to reduce the outstanding Economic Recovery Bond debt and will no longer be available to the department.

According to the department's facilities director, the solution to the problems of the department's aging armories is a balanced program of replacement, modernization, and maintenance and repair. All of these activities involve some degree of federal funding that requires a corresponding expenditure of state funds. The facilities director stated that the maintenance and repair component of the program has been underfunded. He stated that the department is working with the Legislature and the Department of Finance to establish a baseline budget for maintenance and repair of the armories. The baseline would assist the department in justifying its need for increased funds to maintain, repair, and modernize its armories.

To help ensure that the department works toward improved maintenance of its armories, we recommended that the department pursue the balanced program for replacement, modernization, and maintenance and repair advocated by its facilities director. In addition, the department should continue to work with the Department of Finance and the Legislature to establish a baseline budget for the maintenance and repair of its armories.

Department's Action: Pending.

The department reports that it completed construction of two new armories in 2006 and two additional new armories are planned for completion in 2007. In addition, the department states it has completed two of the four armory modernization projects it had planned for 2006. A third modernization project is currently under construction and the fourth is in the final design stage.

The department states that it continues to work with the Department of Finance and the Legislature to establish a budget for the maintenance and repairs of its armories with a goal to eliminate the continued growth in backlogged maintenance and repair, which currently totals over \$36 million.

CALIFORNIA CHILDREN AND FAMILIES COMMISSION

Its Poor Contracting Practices Resulted in Questionable and Inappropriate Payments to Contractors and Violations of State Law and Policies

Audit Highlights . . .

Our review of the California Children and Families Commission's spending practices and contracting procedures revealed that it:

- Allowed one of its media contractors to circumvent the payment provisions of a contract by paying invoices totaling \$673,000 for fees and expenses of some of the contractor's employees that were prohibited under the terms of the contract.*
 - Did not fully use the tools available to it to ensure its contractors provided appropriate services.*
 - Could not always demonstrate it had reviewed and approved final written subcontracts and subcontractors' conflict-of-interest certificates.*
 - Did not always follow state policy when it used a competitive process to award three contracts valued at more than \$47.7 million and failed to provide sufficient justification for awarding one \$3 million contract and six amendments totaling \$27.6 million using the noncompetitive process.*
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REPORT NUMBER 2006-114, OCTOBER 2006

California Children and Families Commission's response as of January 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review the California Children and Families Commission's (state commission) spending practices, planning efforts, and contracting procedures.

Finding #1: The state commission did not enforce contract terms for one contractor, resulting in overpayments totaling more than \$673,000.

The state commission, in paying invoices totaling \$623,000 in fees and expenses submitted by one of its media contractors, allowed the contractor to circumvent the payment provisions of a contract. The contractor claimed the expenses by representing some of its employees as subcontractors. In addition, the state commission paid the media contractor an added \$50,000 fee that was unallowable per the contract. These payments violated the terms of the contract, which allowed for payments based only on the contractor's own services, in the form of commissions applied to the cost of the advertising it placed; no other services or fees were to be charged.

We recommended that the state commission ensure that both it and its contractors comply with all contract terms.

State Commission's Action: Pending.

According to the state commission, its most concerted efforts have been on staff training to ensure that all staff with any contract management responsibility understand the State's contracting procedures. The state commission requested that the Department of General Services (General Services) schedule classes specifically for state commission staff. General Services responded by providing the state commission a schedule of classes for its staff that began

in December 2006 and conclude in April 2007. These classes cover the following topics: documentation, non-competitively bid contracts, evaluation criteria, leveraged procurement agreements, service contracting, non-IT goods under \$5,000, and statement of work. The state commission also stated that it is continuing its own internal training of staff on contract policies and procedures. In addition to the contract monitoring training session it held in October 2006, the state commission plans to provide sessions on the use of the contract shell, invoice review and approval, and conducting bidder conferences, among others, between January and March 2007. Finally, the state commission indicated that it has appointed a specific staff member as the training coordinator both to take the lead on enrolling its staff in necessary training and to track the training status of staff with contract responsibility.

Finding #2: The state commission did not fully use the tools available to it to ensure that its contractors promptly provided appropriate services.

The state commission did not always include certain important elements when developing some of the contracts we reviewed. Specifically, the state commission's contracts did not always include a clear description of work to be performed, schedules for the progress and completion of the work, and a reasonably detailed cost proposal. Further, it did not always ensure that its contractors submitted adequate work plans, that it received all required work plans, and that it promptly approved them. As a result, the state commission cannot ensure that the resulting contracts clearly established what was expected from the contractor, that the contracts provided the best value, and that its contractors provided the agreed-upon services within established timelines and budgets.

We recommended that the state commission ensure that it fully develops its contracts by including clear descriptions of work, schedules for progress and completion of work, reasonably detailed cost proposals, a requirement for adequate supporting documentation for expenses, and clearly defined types of allowable expenses. We also recommended that it consistently enforce contract provisions requiring contractors to submit complete and detailed work plans before they perform services and incur expenses and to ensure that it promptly reviews and approves work plans.

State Commission's Action: Pending.

The state commission again indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend various training courses as described in more detail in the state commission's action related to the first finding. Further, the state commission developed standard language addressing out-of-pocket expenses, which it plans to include in all new contracts that allow such expenses. In addition to describing allowable out-of-pocket expenses, this standard language requires the contractor to obtain clarification from the state commission in advance of incurring an expense when it is unclear under the terms of the contract whether the expense is authorized. The state commission also redesigned the work plans that it will be requiring its public relations contractors to provide beginning in January 2007. These work plans require the contractor to include a detailed description of services and to identify the deliverables, target audience, and proposed completion timeline, as well as other information.

Finding #3: The state commission did not document its oversight of subcontractor agreements and conflict-of-interest certificates.

The state commission could not demonstrate that it had reviewed and approved the final written subcontracts and subcontractors' conflict-of-interest certificates as required. Specifically, our review of a sample of nine contracts and 28 invoices associated with those contracts found that under each contract, the contractors charged for services provided by at least one and sometimes as many as six subcontractors. When we requested these subcontracts and conflict-of-interest certificates, the state commission had to forward our request to its contractors because it did not maintain copies of these documents in its files. Ultimately, it was only able to obtain 19 of a total of 22 requested subcontract agreements. Furthermore, the state commission was only able to obtain either the conflict-of-interest certificate or the conflict-of-interest language embedded within the subcontract for 14 of the 19 subcontracts it obtained. However, it was unable to locate the remaining five certificates. Because the state commission did not maintain these documents in its files, we question whether it reviewed and approved these documents as required before authorizing the use of subcontractors.

Additionally, subcontractors may be unaware of their obligation to preserve records that could be the subject of future audits. The state contracting manual requires contractors to include a provision in subcontracts indicating that the State has the right to audit records and interview staff in any subcontract related to the performance of the agreement. Our review of 19 subcontractor agreements found that five did not contain this language.

We recommended that the state commission establish a process to ensure that it obtains and reviews final written subcontracts and conflict-of-interest certificates before it authorizes the use of subcontractors. Additionally, it should ensure that its contractors include in all their subcontracts a provision indicating that the State has the right to audit records and interview staff in any subcontract related to the performance of the agreement.

State Commission's Action: Partial corrective action taken.

The state commission again indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend various training courses. One of the internal sessions it plans to hold in February 2007 will discuss the review and approval of subcontractors and related documentation. The state commission also revised its standard language regarding the use of subcontractors to educate its contractors more clearly about their responsibilities in providing the necessary documentation for review and approval prior to commencement of work under a subcontract. This language generally requires the contractor to submit to the state commission the final written subcontract and the subcontractor's conflict-of-interest certificate prior to commencing work under the subcontract. Further, the state commission indicated that it uses a General Services' form that contains general terms and conditions as a standard part of its contracts. One of the clauses in that document indicates the State's right to audit records and interview staff in any subcontract related to the performance of the agreement.

Finding #4: The state commission sometimes paid unsupported and inappropriate contractor expenses.

Although prudent business practices and some of its contracts include provisions requiring its contractors to include documentation necessary to support the expenses claimed, our review found that the state commission did not always enforce these provisions. Although generally the state commission received documentation to support the expenses claimed in our sample of 62 payments made to its

contractors, we found both significant and minor instances in which this was not the case. Even when contractors included supporting documentation, the state commission did not always adequately review it before approving payment.

We recommended that the state commission consistently enforce contract provisions requiring contractors to submit supporting documentation for expenses claimed. Further, it should ensure that it performs an adequate review of such documentation before approving expenses for payment.

State Commission's Action: Pending.

The state commission again indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses. One internal session it held in October 2006 was on the topic of contract monitoring and it plans to hold a session in January 2007 on invoice review and approval. While the state commission indicates it is providing training, it does not directly address our recommendation.

Finding #5: The state commission inappropriately advanced funds to three contractors.

The state commission provided advance payments to three contractors even though it does not have the authority to do so. According to the state contracting manual, the State is permitted to make advance payments only when specifically authorized by statute, and such payments are to be made only when necessary. In addition, state laws are designed to ensure that public money is invested in and accounted for in the state treasury. Further, other state laws prohibit making a payment until services have been provided under a contract.

However, the state commission inappropriately advanced \$2.5 million to a public relations contractor for the administration of the state commission's regional community-based organization program. The public relations contractor then took between 30 days and six months to disburse the funds to the selected community-based organizations. Our review of 13 other invoices from the same public relations contractor showed that the state commission advanced it funds for the regional community-based organization program totaling \$6.8 million on three other occasions—invoices dated July 2003, February 2004, and September 2004. Further, the state commission made advance payments in December 2005 and March 2006 to two county commissions totaling more than \$91,500 under memorandums of understanding. When the state commission makes advance payments without the proper authority, it loses the interest it would otherwise earn on these public funds.

We recommended that the state commission ensure it does not make advance payments to its contractors unless it has authority to do so.

State Commission's Action: Corrective action taken.

According to the state commission, the community-based organization program for which it made advances was completed before the bureau raised its concern about these advances. Additionally, the state commission indicated that based on the bureau's recommendation, it cancelled a similar program that was in the pre-disbursement phase. It further stated that it has no current plans to pursue other programs requiring advance payments absent sufficient legal authority to do so.

Finding #6: Although it held strategic planning sessions annually, the state commission has not updated its written strategic plan since 2004.

The state commission poorly managed its process for updating its strategic plan, which outlines the current progress of its initiatives and future plans to advance its vision of school readiness. According to the executive director, the state commission annually either develops a draft plan or updates the prior year's plan, and presents it to the commissioners for their review and approval. However, it last updated its strategic plan in 2004. According to the executive director, although the strategic plan was presented and discussed with the commissioners in January 2004 and January 2005, the state commission did not request their formal approval.

In October 2006 the executive director provided us with a draft copy of a commission proceedings manual. The manual includes an annual commission calendar that lists recurring issues the commissioners are required to consider, such as adopting the strategic plan. The executive director hopes to begin using the manual in January 2007 if the commissioners adopt it.

We recommended that the state commission ensure that it updates its strategic plan annually and presents it to the commissioners for review and approval.

State Commission's Action: Corrective action taken.

According to the state commission, the commissioners reviewed and approved the current strategic plan, which will be in effect until June 30, 2007, during a meeting in October 2006.

Findings #7: The state commission did not always follow state requirements when awarding competitive contracts and it provided insufficient justification for awarding two contracts and six amendments using the noncompetitive process.

The state commission did not always follow state policies during its process of competitively awarding contracts. For instance, it did not fully justify its reason for awarding three contracts, totaling more than \$47.7 million, when it received fewer than the minimum required number of three bids. Also, the state commission was unable to demonstrate that it had advertised a \$90 million contract in the state contracts register as required by state policy.

Moreover, when awarding some of its contracts and amendments using the State's noncompetitively bid (noncompetitive) contract process, the state commission did not provide reasonable and complete justifications for using the process or for the costs of the contracts awarded. Two of the five noncompetitive contracts we reviewed had insufficient justification of the costs of the contract. For one of these contracts, as well as for six of eight amendments to contracts originally awarded using either a competitive bid or the noncompetitive process, the state commission cited insufficient staff resources or time limitations as its reason for using the noncompetitive process. We do not believe that these circumstances are compelling reasons for avoiding a competitive bidding process.

To ensure that it protects the State's interests and receives the best products and services at the most competitive prices, we recommended that the state commission follow the State's competitive bid process for all contracts it awards, unless it can provide reasonable and complete justification for not doing so. Further, it should plan its contracting activities to allow adequate time to use the competitive bid process.

We also recommended that the state commission fully justify the reasonableness of its contract costs when it receives fewer than three bids or when it chooses to follow a noncompetitive bid process. It should also advertise all nonexempted contracts in the state contracts register.

State Commission's Action: Pending.

The state commission indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses, but again does not directly address our recommendations.

Finding #8: Documentation for the scoring of competitive proposals was inconsistent.

Inconsistencies in its documentation of the scoring process for contract bids may leave the state commission open to criticism and challenges to its decisions. It uses a consensus method to score proposals it receives on competitively bid contracts. For the nine competitively bid contracts we reviewed, the state commission retained only the consensus score sheet for each proposal submitted in six of the competitive contracts. Without all the individual scoring materials used in discussing and selecting a winning proposal, it is not possible for us or others to independently replicate the results.

To ensure that it promotes fair and open competition when it awards contracts using a competitive bid process, we recommended that the state commission ensure that it fully documents its process for scoring proposals, and that it retains the documentation.



State Commission's Action: None.

The state commission indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses, but does not specifically address its plans to ensure that it fully documents its process for scoring proposals and for retaining the scoring documentation.

Finding #9: The state commission did not always follow state policies when allowing subcontractors under its interagency agreements and contracts with government agencies.

Of the 24 interagency agreements and four contracts with other government agencies we reviewed, 25 included the services of subcontractors, for a total of at least \$64.6 million. This represents 53.6 percent of the total of \$120.6 million for these agreements and contracts. For 17 of 25 interagency agreements and contracts with other government agencies, the state commission did not always comply with state policies when justifying the use of subcontractors. Three of the 17 appear to have included subcontractors, but the amount of funds subcontractors are to receive is not clear. We also question the justification for the remaining 14 subcontracts totaling \$38.3 million.

To ensure that it follows state policies and protects the State's interest when using interagency agreements and contracts with government agencies, we recommended that the state commission obtain full justification for the use of subcontractors when required and, if unable to do so, deny the use of subcontractors.



State Commission's Action: None.

The state commission's response did not address this recommendation.

Finding #10: The state commission agreed to reimburse contractors for indirect costs at higher rates than state policy allows.

The state commission did not always comply with state policies limiting the amount of administrative overhead fees paid to contractors for each subcontract. In fact, the state commission, in its interagency agreements, approved budgets to reimburse its contractors for over \$1.2 million more than the state contracting manual allows.

To ensure that it follows state policies and protects the State's interests when using interagency agreements and contracts with government agencies, we recommended that the state commission limit the amount that it will reimburse its contractors for overhead costs to the rates established in the state contracting manual.



State Commission's Action: None.

The state commission's response did not address this recommendation.

Finding #11: The state commission circumvented contracting law when it used memorandums of understanding to obtain services.

In fiscal years 2004–05 and 2005–06, the state commission awarded five memorandums of understanding (MOUs) and two amendments totaling more than \$595,000. It appears to have intentionally used some of these to avoid having to comply with state contracting requirements, and for at least two MOUs and one amendment the intention was explicit. Although state contracting law allows agencies to enter into contracts with local government entities without competitive bidding, it strictly prohibits agencies from using these contracts to circumvent competitive bidding requirements.

To ensure that MOUs it awards allow for fair and competitive contracting and protect the State's best interests, we recommended that the state commission follow laws and policies applying to contracts when awarding and administering MOUs.

State Commission's Action: Pending.

According to the state commission, it has suspended its MOU program pending further review.

Finding #12: The state commission consistently failed to obtain approvals for its contracts and amendments on time.

According to state law, all contracts entered into by agencies, except those meeting criteria for exemptions, are not in effect unless and until approved by the Department of General Services (General Services). The state commission failed to obtain the required approvals before the beginning of the contract term for 43 of 45 of the contracts we reviewed. Similarly, it did not obtain the required approvals for 22 of the 44 amendments we reviewed until after the related contract or prior amendment had ended. Although we did not review all of the contracts to determine whether work began before approval, we noted three instances in which the contractor provided services totaling more than \$7 million before the state commission obtained final approval of the contracts. The state commission also failed to obtain the required approvals altogether on three amendments.

To ensure that it does not expose the State to potential financial liability for work performed before the contract is approved, we recommended that the state commission ensure that it obtains General Services' approval of its contracts and amendments before the start of the contract period and before contractors begin work.



State Commission's Action: None.

The state commission did not directly address our recommendation other than to state it is ensuring all staff with any contract management responsibility attend training courses related to contracting procedures.

Finding #13: The commissioners may have improperly delegated authority to award contracts.

State law authorizes the state commissioners to enter into contracts on behalf of the state commission. The commissioners adopted a formal resolution in May 2001 delegating their contracting authority to enter into and amend contracts to state commission staff. In this same resolution, the commissioners took action to ratify all prior contracts. It is our understanding that although the commissioners meet in public session to authorize expenditure authority and specify amounts of money for particular purposes, the ultimate decision to enter into contracts and the selection of providers of goods and services is performed by state commission staff. Our legal counsel advised us that it is a well-accepted principle of law that a power given to a public official that involves the exercise of judgment or discretion may not be delegated to others without statutory authority. In this case, no statute authorizes the commissioners to delegate their contracting authority.

To ensure that the state commission staff may lawfully enter into or amend contracts on behalf of the commissioners, we recommended that the state commission seek appropriate legal counsel.

State Commission's Action: Pending.

The state commission stated that it is in the process of hiring a chief counsel, who it will ask to review the bureau's recommendation regarding delegation of contracting authority.

LOS ANGELES UNIFIED SCHOOL DISTRICT

It Has Increased Administrative Positions for Various Reasons and Although Making Progress, Its Performance Evaluation and Salary-Setting Procedures for Managers Still Need Improvement

Audit Highlights . . .

Our review of the Los Angeles Unified School District's (LAUSD) reorganizations and its procedures for evaluating performance and setting salaries for managers found that:

- Both the 2000 and 2004 reorganizations achieved staffing reductions, but by December 2005 support services staffing levels had increased to levels that exceed those existing before the 2000 reorganization, which LAUSD attributed to the need for additional employees to manage school construction and information services efforts.*
- Only four of the eight local district Parent/Community Advisory Councils (advisory councils) created by the 2000 reorganization plan are still operating, and LAUSD has not attempted to measure parent satisfaction with the remaining advisory councils.*
- Although LAUSD has established measurable benchmarks and goals for the superintendent, it has not replicated this practice with other managers responsible for improving student achievement.*

continued on next page . . .

REPORT NUMBER 2005-132, SEPTEMBER 2006

Los Angeles Unified School District's response as of November 2006

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to evaluate the cost and position reductions resulting from the Los Angeles Unified School District's (LAUSD) 2000 and 2004 reorganizations. Also, the audit committee asked us to determine if community and parent access and participation had increased as a result of the 2000 reorganization. Further, we were asked to determine whether LAUSD periodically evaluates its administrative organization and whether it uses performance measures to evaluate staff. In addition, we were asked to analyze its salary-setting practices and determine whether high-level executive and administrative salaries continue to differ from similar positions in other school districts. Finally, the audit committee asked us to determine the extent to which LAUSD implemented recommendations from our July 2001 audit. In doing so, we noted the following findings:

Finding #1: LAUSD did not achieve lasting reductions in support services positions proposed in its 2000 and 2004 reorganizations, and has not adequately tracked their impact.

Support services employees are those that do not interact directly with students but rather provide administrative and operational support for LAUSD. In 2000 LAUSD proposed to cut 835 support services positions at its central office, including shifting 501 of these positions to regional offices and schools. However, it cut only 664 positions, almost all of which were shifted to regional offices. In contrast, the 2004 reorganization plan proposed cutting 205 support positions but LAUSD actually cut 231 such positions. These staffing reductions were temporary because by December 2005 support services staffing had increased to levels that exceeded those existing prior to the 2000 reorganization. LAUSD indicates that many of these additional employees were needed to manage its school construction and information services efforts. We also noted that the salaries and benefits costs of LAUSD's support services positions increased at a faster

☑ *LAUSD has addressed many of the concerns over the salary-setting practices that we noted in a July 2001 audit, but its Personnel Commission still does not have written procedures for determining salaries or appropriate documentation to support salary-setting recommendations for classified managers and executives.*

☑ *Based on our survey of four of the nation's largest school districts, LAUSD's salaries are higher than those of comparable positions for more than half of the 27 high-level positions surveyed, but there may be factors that justify such differences.*

rate than those same costs for the school services group—employees that are located at school sites—between fiscal years 1999–2000 and 2004–05.

When the LAUSD Board of Education (board of education) adopted the 2000 reorganization plan, it required the district to perform some follow-up studies. Although LAUSD has updated the board of education on changes to its administrative structure since the reorganization, it has not reported the financial changes resulting from the reorganization as the board has requested.

We recommended that when LAUSD makes major changes in its organizational structure with the intent of improving its operations, it consider ways to track the impact of these organizational changes on such factors as staffing and cost.

LAUSD's Action: Pending.

LAUSD states that it currently has the ability to only gather aggregate information relative to the impact of an organizational change. However, LAUSD is implementing an enterprise resource planning system, called Business Tools for Schools, which it believes will provide a comprehensive way to track and analyze data from its business, financial, and human resource functions. LAUSD states that the elements of the financial system were implemented in fall 2006 and that the human resources and budgeting systems are scheduled for implementation in winter and spring of 2007. Given this schedule, LAUSD believes that enhancements to its ability to analyze organizational staffing changes should be realized a year later, in June 2008.

Finding #2: LAUSD did not fully develop the six performance metrics it had proposed when expanding its legal staff in 2001.

LAUSD expanded its legal services staff in 2001 to improve the quality of legal services it receives. It proposed to evaluate this expansion through six performance metrics. Although LAUSD tracks data related to the metrics, it did not fully develop them by setting quantifiable goals and measuring itself against those goals. Without establishing such goals and targets, LAUSD lacks an objective way to determine which goals it is meeting and which ones it is not, which will aid in reevaluating its operations.

We recommended that LAUSD develop performance metrics with goals and quantifiable benchmarks to evaluate itself on its progress in achieving planned improvements.

LAUSD's Action: Corrective action taken.

LAUSD states it has now developed performance objectives for fiscal year 2006–07 relating to each of the six performance measures included in its legal reorganization plan. Each of the performance objectives establishes specific and measurable goals, which, if properly monitored, should allow LAUSD to measure whether it is making progress against the six performance measures.

Finding #3: Parent/Community Advisory Councils are not serving the purpose that the 2000 reorganization plan intended.

The 2000 reorganization plan created Parent/Community Advisory Councils (advisory councils) at each local district to provide parents and community members with access to local district administrators and the ability to provide feedback on district policy. However, only four of the eight local districts currently have active advisory councils and only two are functioning as the plan intended. The remaining two serve to receive information from district administrators. Additionally, LAUSD has not attempted to measure the impact that the advisory councils may have on access to district administrators and the policy-making process.

If LAUSD decides to continue with the advisory councils, we recommended that it evaluate why advisory councils have not met the objectives in the 2000 reorganization plan, develop more specific guidelines on what they should accomplish, define the local districts' roles, and develop a mechanism to monitor and oversee them.

LAUSD's Action: Pending.

LAUSD indicates that it will conduct a study of parent services at all levels of the district, including the effectiveness of the advisory councils, and will report on the study results in its six-month response to our audit. As a part of the larger issue of building parent partnerships, the new superintendent will be considering whether LAUSD should continue with the advisory councils.

Finding #4: LAUSD has not established performance benchmarks or maintained performance evaluations for the majority of its executive managers.

The board of education has established specific, easily measurable goals for the superintendent, but the superintendent has not replicated this practice with LAUSD's local district superintendents or other executive managers. A January 2006 review of LAUSD by a peer group of other school administrators—the Council of the Great City Schools—also found little evidence that district staff were evaluated explicitly on their ability to attain specific goals and benchmarks or faced consequences for failing to meet performance goals. As a result, LAUSD may not be able to assess the performance of certain executive managers effectively because it has not established specific and measurable performance standards.

Further, of the 28 evaluations for executive managers we requested, LAUSD was able to provide performance measures only for the superintendent, and evaluations for two key administrators. LAUSD indicates that some performance evaluations were not available because the superintendent does not perform written evaluations and others were unavailable because the records could not be located or had been destroyed. Performance evaluations can be useful tools to measure and direct the progress of LAUSD's efforts to improve student outcomes. Without copies of evaluations to draw on, LAUSD may limit its ability to track and hold executive managers accountable for their performance over time.

To measure the effectiveness of executive managers, we recommended that LAUSD establish specific, measurable, and reasonable goals for these administrators that are aligned with the district's goals and hold them accountable for their performance. When establishing these goals, LAUSD should do so in conjunction with implementing the January 2006 peer group's recommendations. We also recommended that LAUSD evaluate key administrators in writing based on their ability to meet their goals, and ensure that it retains these written evaluations for a reasonable time period.

LAUSD's Action: Partial corrective action taken.

In line with the peer group's recommendations, LAUSD reports drafting performance objectives and measures aligned with its mission and superintendent's goals for eight central office senior instructional managers and three senior-level instructional positions at each of the local districts. LAUSD indicates it will develop performance measures and objectives for its remaining senior managers, including non-instructional positions, by April 30, 2007. In addition, LAUSD states it is working on a process to ensure evaluations of senior managers are performed in writing and retained in each employee's permanent file.

Finding #5: LAUSD's Personnel Commission does not have written procedures for setting classified employee salaries and it does not maintain complete records of its salary determination process.

Classified employees are those whose positions do not require an education-related certification. The Personnel Commission relies on several methods to set salaries for LAUSD classified employees, but it lacks written procedures for determining salaries to ensure that its staff applies these methods consistently. Further, the written guidelines it does have are vague and are not policy that staff must follow. It also lacked documentation to support the salary recommendations for 11 of the 15 salary-setting decisions we reviewed for classified administrators. The lack of comprehensive written procedures and insufficient documentation leaves the Personnel Commission vulnerable to criticism that the process it uses to set salaries lacks objectivity, thoroughness, and consistency.

We recommended that to avoid the appearance of subjectivity and lack of thoroughness, LAUSD's Personnel Commission should establish written guidelines for setting salaries and ensure that it consistently follows these processes for determining administrative compensation. It should also maintain complete records of its salary determination process, including methods and information used to support its decisions.

LAUSD's Action: Pending.

As part of an overall plan to standardize and consolidate the salary assignment process, LAUSD reports that the Personnel Commission is working with LAUSD's Human Resources Division to jointly develop a process for evaluating positions when making salary-setting decisions. In addition, LAUSD has proposed expanding the role of the existing Superintendent's Compensation Advisory Council to include review of classified as well as certificated positions. Under the proposal, this council would be renamed the Management Advisory Council and its role would include reviewing salary-setting decisions to help create a balance between certificated and classified salaries. Also, LAUSD indicates that the Personnel Commission is updating its guidelines for conducting salary surveys, including augmenting the criteria used for salary recommendations and documenting its methodology. A draft of these efforts are scheduled to be submitted to the Personnel Division by December 31, 2006.

Finding #6: LAUSD has only limited documentation to support the salary levels of executive-level administrators that the superintendent and board of education determine.

The superintendent determines salaries for executive-level certificated positions hired on employment contracts, and the board of education determines salaries for executive-level positions that report to it. However, both the superintendent and the board of education lack written procedures for determining these salaries and did not maintain detailed documentation to support salary levels set for the 12 positions we reviewed. However, based on our interviews and review of the limited documentation that existed, they appear to use reasonable practices in their salary-setting decisions.

We recommended that LAUSD maintain complete records to support salary determinations for executive-level administrators to show that these determinations are based on reasonable and objective criteria.

LAUSD's Action: Pending.

LAUSD indicates that it will be taking steps to ensure that appropriate documentation is retained to support the salary levels of executive-level administrators that the superintendent and board of education establish. These steps include integrating those salary levels into a new master salary schedule, developing a new point-factor system for evaluating these positions' salary levels, and creating file storage protocols for these salary-setting procedures.

Finding #7: LAUSD has taken steps to implement most of the recommendations from our July 2001 audit.

In July 2001 we issued a report titled *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 (2000-125)*. The report concluded that LAUSD had made some progress in implementing its 2000 reorganization plan (plan); however, it has not shifted to local districts the level of authority over financial resources or instructional programs described in its plan. Also, we found that some administrative management positions earned substantially more in comparison to positions at other school districts, while a few positions earned less. Because it lacked formal guidance for determining what salaries to award, we concluded that the propriety of some of these compensation levels was questionable. Furthermore, we found that LAUSD lacked updated job descriptions for these positions and was unable to provide adequate documentation detailing how it set compensation levels for some positions.

During our current audit we found that LAUSD has fully implemented most of the July 2001 audit's recommendations, but it either has not implemented or only partly implemented our recommendations concerning performance measurements and salary-setting procedures as noted in findings 4, 5, and 6 above.

EMERGENCY PREPAREDNESS

California's Administration of Federal Grants for Homeland Security and Bioterrorism Preparedness Is Hampered by Inefficiencies and Ambiguity

REPORT NUMBER 2005-118, SEPTEMBER 2006

Audit Highlights . . .

Our review of California's administration of federal grants for homeland security and bioterrorism preparedness revealed that:

- The State's two annual statewide exercises have not sufficiently tested the medical and health response systems.*
 - The Governor's Office of Emergency Services (Emergency Services) and the Governor's Office of Homeland Security have been slow in spending federal grant awards for homeland security.*
 - Emergency Services is behind schedule in its receipt and review of county and state agency emergency response plans.*
 - The California Department of Health Services has not finalized its plans to conduct on-site reviews of subrecipients.*
 - The State's organizational structure for ensuring emergency preparedness is neither streamlined nor well defined.*
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California Department of Health Services', the Governor's Office of Emergency Services', and the Governor's Office of Homeland Security's responses as of November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the State's administration of federal grants for homeland security and bioterrorism preparedness. We were asked to determine whether state entities are administering these grants in an efficient and effective manner. Specifically, the audit committee requested that we identify the state entities responsible for homeland security and bioterrorism preparedness, their roles, and how they coordinate and communicate with each other. It also asked that we review and assess how state entities plan and train for responding to a terrorist attack and the scale or criteria the State uses to determine the seriousness of a potential terrorist attack. Additionally, the audit committee asked that we determine how state entities ensure compliance with their policies and procedures, including a review of the State's procedures for monitoring funds distributed to local entities. The audit committee further requested that we examine the State's homeland security and bioterrorism preparedness funding, expenditures, and encumbrance activities, including policies for prioritizing expenditures, how state entities have spent federal homeland security and bioterrorism preparedness funds, expenditure rates, and criteria for determining the amount of funding local entities receive from the State. Finally, the audit committee asked that we identify impediments to the efficient and effective investment of federal homeland security and bioterrorism preparedness funds. We performed most of our audit work at three state entities: the California Department of Health Services (Health Services), the Governor's Office of Emergency Services (Emergency Services), and the Governor's Office of Homeland Security (State Homeland Security).

Finding #1: Annual statewide exercises have not sufficiently tested California’s medical and health systems.

Although the State has been conducting emergency exercises simulating various threats throughout the last few years, California’s two major annual exercises—the Golden Guardian exercises created by State Homeland Security and the Statewide Medical and Health Disaster exercises created by the Emergency Medical Services Authority—have not exerted sufficient stress on the State’s medical and health systems to determine how well they can respond to emergencies. In 2005, Golden Guardian included a simulation involving about 550 casualties suffering from moderate-to-acute injuries or who died at the scene. Because that number is at the low end of the range of 250 to 10,000 casualties estimated for a moderate-size emergency, Golden Guardian lacked sufficient realism. Also, according to one Golden Guardian participant, the exercise tested medical mutual aid from a source that would not be used during an actual emergency. Further, although the Statewide Medical and Health Disaster Exercise was designed to fulfill exercise needs for local medical and health systems, it has not tested the medical and health mutual aid systems on a statewide basis. As a result, California does not know how well its medical and health systems can respond to all emergencies.

Emergency Services is the lead agency for emergency management in California. One of the four phases of emergency management is preparedness. Exercises are a type of activity that occurs within the preparedness phase. Emergency Services raised concerns about the 2005 Golden Guardian exercise. In a February 2006 letter, Emergency Services’ director stated that “inadequate integration of the [state emergency management system] by [State Homeland Security], coupled with unfocused objectives, caused exercise design flaws and problems in the exercise play.” The director also noted, “local participants have stated that [Golden Guardian 2005] was confusing and frustrating and called into question the credibility of the State’s level of preparedness.”

To better prepare the State for responding to terrorism events and other emergencies, state entities, including State Homeland Security and Emergency Services, should ensure that future exercises are as realistic as possible and sufficiently test the response capabilities of California’s medical and health systems.

Emergency Services’ Action: Pending.

Emergency Services stated that stressing the medical and health systems will certainly be the focus of future statewide exercises. Further, under statutory authority as the lead emergency management agency in the State, Emergency Services is strengthening its statewide exercise program designed to test policy, plans, and procedures and its associated training program for an all-hazards concept of response and recovery. Emergency Services plans to develop an outline for the statewide exercise program by March 2007, present a final draft of the outline to stakeholders by September 2007, and implement the plan in December 2007.

State Homeland Security’s Action: Partial corrective action taken.

State Homeland Security stated that it incorporated the Statewide Medical and Health Exercise into the 2006 Golden Guardian Exercise for the first time. It also stated that more than 100 hospitals participated in the 2006 Golden Guardian Exercise, which included 20,000 injuries that required hospital beds and 72,000 treated and released at the scene. State Homeland Security further stated that it will continue to test aspects of the medical health system in the next Golden Guardian exercise and that it will use a variety of exercises to test the medical system, including tabletop, functional, and full-scale exercises. Finally, State Homeland Security stated that it will build on previous and current Golden Guardian efforts as part of future planning.

Finding #2: California's spending of some federal funds has been slow.

The State has not promptly spent federal funds received since 2001 for homeland security. As of June 30, 2006, Emergency Services and State Homeland Security had spent only 42 percent of the funds granted to the State for homeland security. The slow pace of spending of the homeland security funds is a sign that California may not be as prepared as it otherwise could be. Local entities we contacted offered several reasons for the slow spending, including the State's slow process for reimbursing local entities. To determine the length of time it took the state to process reimbursement requests, we examined samples of payments made at two points during 2006. Our review of the first sample showed that it took Emergency Services and State Homeland Security an average of 66 days to process reimbursement requests. For the second sample, it took the two entities an average of 41 days. Based on the results of our testing, the State's current reimbursement process probably does not contribute significantly to the inability of subrecipients to spend federal grants. However, both averages exceed the 30-day maximum established in law for state entities to process invoices from its contractors. We believe this is a reasonable benchmark. Local entities also mentioned the combination of the short time allowed for developing budgets and the time-consuming budget-revision process as obstacles, and identified local impediments to quicker spending, including procurement rules and a lack of urgency.

To identify steps that could be taken to help increase the pace of spending for federal homeland security grants, State Homeland Security should create a forum for local administrators to share both best practices and concerns with state administrators. Further, to reduce the amount of time necessary to reimburse local jurisdictions for their homeland security expenditures, State Homeland Security and Emergency Services should collaborate to identify steps they can take.

Emergency Services' Action: Partial corrective action taken.

Emergency Services stated that it and Homeland Security are working cooperatively and are committed to reducing the processing time for all reimbursement claims. It also indicated that, although it is currently processing payments within 35 to 40 days, its goal is to reduce the processing time down to 30 days.

State Homeland Security's Action: Partial corrective action taken.

State Homeland Security stated, among other things, that it will continue to create forums for local administrators to share best practices and concerns with the State. State Homeland Security cited the expansion of its Program and Capability Review (PCR) from 200 participants to as many as 1,000 as an example. State Homeland Security stated that during the PCR, local administrators will have time to discuss grant issues and other types of issues with counterparts from around the State. It will also include best practices workshops as part of the PCR. State Homeland Security also mentioned that it will host an annual statewide conference in early spring 2007 at which it will encourage the sharing of best practices by giving local agencies the opportunity to explain what has worked for them and some of the problems they encountered along the way.

Regarding steps to reduce the time necessary to reimburse local jurisdictions, State Homeland Security indicated that it has been working with Emergency Services to coordinate activities. It also stated that it will implement a process for getting payments to Emergency Services' accounting office within 15 days and, to help achieve this goal, it will create and fill an additional payment processing position.

Finding #3: State reviews of emergency response plans are behind schedule.

The state emergency plan and other existing emergency and mutual aid plans guide public entities during their response to declared emergencies, in conjunction with the emergency operations plans established by local governments and state agencies. Emergency Services, however, is behind schedule in its receipt and review of the emergency operations plans for 35 of California's 58 counties and those of 17 of 19 state entities that are key responders during emergencies. As a result, California cannot ensure that these plans incorporate all relevant changes in agency reorganizations, new laws, and experience with both exercises and actual disasters. California also has less assurance that these plans will effectively guide the entities in their response to emergencies. The current status of the State's review of local and state agency plans is the result of weak internal controls.

To ensure that emergency plans of key state entities and local governments are as up-to-date as possible, integrated into the State's response system, and periodically reviewed, Emergency Services should develop and implement a system to track its receipt and review of these plans.

Emergency Services' Action: Partial corrective action taken.

Emergency Services stated that it will include the emergency planning process as part of its effort to update the state emergency plan. The revised state emergency plan will define the update schedule for the State's plan and define the supporting plans and their update schedule. Emergency Services estimates that the completion date for the updated state emergency plan is January 2008.

Emergency Services also stated that it is completing a database to include the emergency-related plans and other documents for state agencies and operational areas. It stated that it will work with state agencies and operational areas to enter the information into the database. It also stated that it will assign staff to oversee the database, notify entities of the need for upcoming updates, and monitor development of emergency plans. Emergency Services has set a target date of January 2007 for the completion of this database.

Finding #4: Grant monitoring efforts are expanding.

Current efforts by the State to monitor subrecipients' use of homeland security and bioterrorism preparedness funds appear to comply with the minimum requirements set by the federal government. Generally, the State performs the four types of monitoring suggested by federal guidance: technical assistance, desk reviews, independent audit reports, and on-site monitoring. However, only State Homeland Security performs on-site reviews to examine subrecipients' use of federal grant funds. Legislation enacted in July 2005 requires Health Services to begin reviewing subrecipient cost reports by January 2007. Planning documents indicate that Health Services intends to perform these reviews on site. Health Services was continuing with its planning efforts as of August 2006.

To ensure that it can implement in January 2007 the provisions of Chapter 80, Statutes of 2005, related to auditing cost reports from subrecipients of federal bioterrorism preparedness funds, Health Services should complete its planning efforts.

Health Services' Action: Partial corrective action taken.

According to Health Services, it remains on schedule to implement auditing of subrecipients. Health Services told us that audit instruments have been developed and staff will initiate audits in January 2007.

Finding #5: The State's preparedness structure is neither streamlined nor well defined.

Although California's structure for responding to emergencies is established in state law and is very streamlined, its structure for preparing for emergency response is a labyrinth of complicated and ambiguous relationships among myriad entities. Emergency Services and State Homeland Security, as well as the numerous committees that provide advice or guidance to the three state entities that administer federal grants for homeland security and bioterrorism preparedness, are working within a framework of poorly delineated roles and responsibilities. If this status continues, the State's ability to respond to emergencies could be adversely affected. It appears that the current structure for preparedness arose as the State reacted administratively to guidance from the federal government and created its own requirements to fill perceived needs.

To simplify and clarify California's structure for emergency response preparation, the following steps should be taken:

- The governor and the Legislature should consider streamlining the preparedness structure. For instance, they should consider establishing one state entity to be responsible for emergency preparedness, including preparedness for emergencies caused by terrorist acts.
- The Legislature should consider statutorily defining the preparedness structure in law.
- The Legislature should consider statutorily establishing State Homeland Security in law as either a stand-alone entity or a division within Emergency Services. Further, if it creates State Homeland Security as a stand-alone entity, the Legislature should consider statutorily defining the relationship between State Homeland Security and Emergency Services.

Legislative Action: Legislation proposed.

As of December 8, 2006, we are aware of only one bill that addresses our recommendations. On December 4, 2006, Assemblymember Nava introduced AB 38 to transfer State Homeland Security from the Governor's Office to become a division within Emergency Services. Further, Emergency Services told us that it was working with the legislative leadership to determine how to best structure the relationship between it and State Homeland Security in state law. We are unaware of other actions taken by the Legislature to address our recommendations.

DEPARTMENT OF INDUSTRIAL RELATIONS

Its Division of Apprenticeship Standards Inadequately Oversees Apprenticeship Programs

Audit Highlights . . .

Our review of the Department of Industrial Relations' (department) Division of Apprenticeship Standards' (division) oversight of apprenticeship programs (programs) found that:

- The division suspended program audits in 2004 and did not follow up on corrective action related to audits it had started.*
- The division has not resolved apprentice complaints in a timely manner, taking over four years in some cases to investigate the facts of complaints.*
- The division has not adequately monitored the apprentice recruitment and selection process. In particular, it has not conducted Cal Plan reviews since 1998.*
- Division consultants did not consistently provide oversight through attendance at committee meetings.*

continued on next page . . .

REPORT NUMBER 2005-108, SEPTEMBER 2006

Labor and Workforce Development Agency's response as of November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the apprenticeship programs (programs) regulated by the Division of Apprenticeship Standards (division) and the California Apprenticeship Council. Specifically, the audit committee asked us to review and evaluate the laws and regulations significant to the programs and to identify the roles and responsibilities of the various agencies involved in them. It also asked us to determine the type of data collected by the division for oversight purposes and the extent to which it uses the data to measure the success of the programs and to evaluate the division's performance/accountability measures. In addition, the audit committee asked us to examine data for the last five fiscal years regarding the programs' application, acceptance, enrollment, dropout, and graduation rates, including the rates for female and minority students, and the programs' graduation timetables. Further, the audit committee asked us to review the extent and adequacy of the division's efforts related to recruitment into state-approved programs, and to identify any potential barriers to student acceptance into the programs. The audit committee wanted to know whether the division's management and monitoring practices have complied with relevant statutory requirements and whether the division has taken action against programs that do not meet regulatory or statutory requirements. Finally, the audit committee asked us to review the program's funding structure to determine whether employer contributions to programs reasonably relate to the costs of providing training. In our review, we noted the following findings:

Finding #1: The division suspended program audits in 2004 and did not follow up on corrective action related to audits it had started.

Although state law required it to begin randomly auditing approved programs during each five-year period beginning January 1, 2000, the division did not complete the audits it started, and it stopped

- ☑ *The division's staffing levels have not increased in step with legal obligations, and it has failed to document priorities for meeting these obligations for existing staff.*
- ☑ *The division did not report annually to the Legislature for calendar years 2003 through 2005, and the annual reports contain grossly inaccurate information about program completion.*
- ☑ *The department is slow to distribute apprenticeship training contribution funds. Only \$1.1 million of the roughly \$15.1 million that had been deposited into the training fund by June 30, 2005, has been distributed as grants.*
- ☑ *The division does not properly maintain its data on the status of apprentices.*

conducting audits in February 2004. Program audits are the means by which the division can ensure that the committees, which sponsor the programs, are following their state-approved standards and they allow the division to measure programs' success.¹ The division chief, appointed in 2006, said he was told there had been insufficient staff to complete the audits, however, he indicated that the division planned to resume audits consistently in October 2006. A comprehensive audit plan that subjects all programs to possible random audits, gives priority to auditing programs with known deficiencies, and targets programs with a high risk profile would maximize the use of the division's limited audit resources. Until the division resumes its audits and ensures that the committees correct any weaknesses in their programs, it will have difficulty measuring the success of the programs and the quality of the training apprentices receive.

We recommended that the division follow through on its planned resumption of audits of programs and ensure that recommendations are implemented and that audits are closed in a timely manner. Additionally, the division should request that the Legislature amend auditing requirements to allow it to select programs for audit using a risk-based approach.

Division's Action: Partial corrective action taken.

The division stated that it has filled its consultant and field support vacancies and will begin audits in late November 2006. It indicated that the division will primarily use a risk-based approach to select programs to audit, choosing programs whose graduation rates are less than 50 percent of the average rate for their trade. In addition, the division will select one program randomly from the remaining population for every five programs chosen under the risk-based approach. The division stated it will consider legislation during the 2007 legislative session to clarify audit requirements and the selection process.

Finding #2: The division has not resolved apprentice complaints in a timely manner or adequately monitored the apprentice recruitment and selection process.

State regulations require the director of the Department of Industrial Relations (department) to receive, investigate, and decide on complaints filed by apprentices. However, until recently the division did not consistently track these complaints. As a result, it did not

¹ Apprenticeship program sponsors—joint apprenticeship committees, unilateral labor or management committees, or individual employer programs—submit to the division an application for approval of their programs, along with proposed program standards and other relevant information. Because committees were the program sponsors for more than 97 percent of all active apprentices as of December 31, 2005, we refer to program sponsors as committees throughout the report.

review, investigate, and issue decisions in a timely fashion. Although there is no regulatory or statutory time limit for the division to investigate and resolve apprentice complaints, a time period of more than two years—and more than four years in some cases—to investigate the facts of a complaint seems excessive. Most of the complaints we reviewed that remained open in June 2006 related to allegations of unfair cancellation or suspension of an apprentice from a program. In these situations, a timely determination is critical because apprentices who were unfairly canceled are unable to become journeymen in their chosen field.

Furthermore, the division has not conducted adequate oversight of the committees' apprentice selection procedures to ensure that they promote equality of opportunity in state-approved apprenticeship programs. State regulations require committees to submit their apprenticeship selection standards to the division for approval. Among other things, the standards include provisions the committees use for determining the qualifications of apprentice applicants and uniform procedures for assuring the fair and impartial selection of applicants. State regulations also require the State of California Plan for Equal Opportunity in Apprenticeship (Cal Plan) to be incorporated into the standards. However, the division exercises limited oversight over the implementation of the committees' selection procedures. Its division chief stated that the division has not conducted systematic reviews of apprenticeship programs, also known as Cal Plan reviews, since 1998 due to insufficient staff. Consequently, the division cannot determine the extent to which committees comply with their Cal Plans. Finally, state law requires the division to coordinate the exchange of information on available minorities and women who may serve as apprentices. The division's failure to monitor selection processes makes it nearly impossible to determine whether committees are adhering to equal opportunity requirements or to identify potential barriers for women and minorities.

We recommend that the division work with the department's legal division to establish time frames for resolving complaints and develop a method for ensuring that complaints are resolved within the time frames. Also, the division should require committees and their associated third-party organizations to maintain documentation of their recruitment and selection processes for a time period consistent with Cal Plan requirements and should conduct systematic audits and reviews of apprenticeship recruitment and selection to ensure compliance with Cal Plan requirements and state law. Finally, the division should develop a process for coordinating the exchange of information on available minority and female apprentices.

Division's Action: Partial corrective action taken.

The division said that complaints have been assigned to one individual in the headquarter's office and that the status of complaint processing is reviewed each week during standing meetings with the division chief. Further, the division and the department's legal division have developed a communications process to ensure that complaints are processed timely. The division believes that once the current backlog is processed, the volume of complaints should be relatively low and manageable.

The division indicated that it intends to conduct Cal Plan reviews of each program once every three years and that its review of the first one-third under the new system is nearly complete. The division stated that these reviews found many programs that will need to update their standards and will require a follow-up review in 2007. The division did not address the recommendation related to coordinating the exchange of information on available minority and female apprentices.

Finding #3: Division field offices can improve their oversight of the committees and the division has not documented priorities for existing staff.

Consultants working in the division's field offices can improve their oversight of the committees. A key role of the division's consultants, each of whom oversees an assigned group of committees, is to attend committee meetings, especially if an apprentice is to appear before a committee. Despite the stated importance of the consultants' attendance at committee meetings, our review of files at six field offices found that consultants did not consistently attend these meetings. The field offices also lack a formal, centralized process for tracking the resolution of issues or questions that may arise at committee meetings or during the normal course of business. Further, the consultants do not consistently enforce regulations requiring committees to complete self-assessment reviews and program improvement plans. Finally, although state regulations allow the division chief to cancel programs that have had no active apprentices for two years, until recently the consultants had not consistently identified inactive programs. Maintaining an up-to-date list of apprenticeship programs is important because the division can use it to more evenly prioritize and distribute the number of committees each of its consultants is responsible for, improving their ability to monitor their committees.

The division chief indicated that a lack of staff has prevented the division from completing its monitoring requirements. His priority for 2006 was to focus on customer service and to improve the division's processes to enable staff to meet requirements in a timely and accurate manner; his priorities for 2007 are to focus on promotion and expansion of apprenticeship into trades not typically associated with apprenticeship, and to ensure the quality of programs through consistent implementation of oversight activities.

We recommended that the division document specific priorities and goals for its staff both to maximize the use of existing staff and to identify additional staffing needs. We also recommended that the division require its consultants to enforce regulations that call for committees to submit self-assessment reviews and program improvement plans.

Division's Action: Corrective action taken.

The division stated that it has established goals, strategies, and standards, which have been communicated to staff. In addition, the division has developed performance measurements for the standards. Finally, the division has set priorities related to oversight activities including attendance at committee meetings; focused site visits; and ensuring the completion of self-assessment reviews, program improvement plans, program audits, and Cal Plan reviews.

Finding #4: The division does not adequately track and disseminate information to the Legislature as state law requires and the department is slow to distribute apprenticeship training contribution funds.

State law requires the division chief and the California Apprenticeship Council to report annually to the Legislature and the public on their activities. According to its chief, the division did not do so for calendar years 2003, 2004, and 2005, thus missing the opportunity to make the Legislature aware of the apprenticeship programs and gain valuable feedback on the direction of the programs. The annual reports that have been prepared also contain grossly inaccurate information about the number of apprentices that complete the program due to a programming error.

Furthermore, although state law mandated the department to begin distributing grants to programs from the apprenticeship training contribution fund (training fund) in 2003, it did not distribute its first grants until May 2006. The department has had the authority to spend \$1.2 million on grants in each of the last three fiscal years. Its budget officer attributes part of this delay to a lack of regulatory authority on how to calculate the grant amounts.

While the department has distributed \$1.1 million in grants as of June 2006, it has spent significantly more on division operations. As of June 30, 2005, about \$15.1 million had been deposited into the training fund. During fiscal years 2001–02 through 2004–05, the division used a total of \$4 million from this fund to pay for salaries, benefits, and other costs. Additionally, during fiscal years 2002–03 and 2003–04, a total of \$2.8 million was transferred from the training fund to the State’s General Fund. Consequently, the June 30, 2005, fund balance was \$8.3 million. Clearly, the use of \$4 million primarily for general division expenses prior to the distribution of grants adversely affects the division’s ability to fund grants to committees because less cash is available to support increases in spending authority for grants and subsequent grant distributions.

We recommended that the division ensure that it submits annual reports to the Legislature that are accurate, timely, and consistent with state law. We also recommended that the department request increased budgetary authority as necessary to distribute apprenticeship training contribution money received each fiscal year and the training fund balance as grants to applicable programs. If the department believes that amounts collected from employers for deposit into the training fund should be used to fund division expenses at the same priority level as grants to apprenticeship programs, the department should seek statutory changes that clearly reflect that employers are also funding general expenses.

Department’s Action: Partial corrective action taken.

The division stated that a report for 2003 through 2005 will be posted on its Web site once the administration has approved it and the Legislature receives it. In addition, the division has created an annual calendar that includes a task for submitting the report in July of each year.

The division said that \$1.2 million in grant distributions for fiscal year 2006–07 is in process and that it will use appropriate budget mechanisms to increase distributions as justifiable. The department believes that it has the legal authority to use the money deposited in the training fund for purposes beyond the cost of administering the processing of checks and distribution of grants. Therefore, it does not believe that additional statutory changes are necessary.

Finding #5: Information in the division’s database could be used to oversee programs, if better maintained.

Because the division does not properly maintain its data on the status of apprentices, it cannot determine actual program performance, such as the rate at which apprentices cancel or complete their apprenticeships. Field office staff are responsible for updating and verifying the information entered in the database; however, according to a few of the consultants, staffing limitations prevent them from performing this function on a regular basis. Thus, the division’s deputy chief, on a case-by-case basis, sends committees an electronic listing of active apprentices in their programs and asks them to update the information, which he then uses to update the database. A standardized process for updating the database on a regular basis could help increase the accuracy of the information it contains. If accurate, the division could use this information to set performance goals, pinpoint program successes and failures, and focus its monitoring efforts.

We recommended that the division establish a process for regularly reconciling information on the current status of apprentices with information maintained by committees and use data to set performance goals and to pinpoint program successes and failures.

Division's Action: Pending.

The division stated that it and two software vendors are testing a new electronic data interchange function for the initial and recurring synchronization of apprentice records. It expected to have this feature available for all programs with the software by the end of 2006. The division will create a web-based program for those programs without apprenticeship management software.

BOARD OF EQUALIZATION

Its Implementation of the Cigarette and Tobacco Products Licensing Act of 2003 Has Helped Stem the Decline in Cigarette Tax Revenues, but It Should Update Its Estimate of Cigarette Tax Evasion

Audit Highlights . . .

Our review of the Board of Equalization's (Equalization) implementation of the Cigarette and Tobacco Products Licensing Act of 2003 (act) revealed the following:

- Based on its analysis of cigarette tax stamps sold, Equalization estimates it received \$75 million in additional cigarette tax revenues between January 2004 and March 2006 because of the act and the new tax stamp.***
- Equalization's estimate of \$292 million in annual cigarette tax evasion is based on an unrepresentative sample and an overstated number of retailers of cigarettes and tobacco products.***
- Although the act and new tax stamp have caused a stabilization of the historical decline in cigarette tax revenues, these revenues will continue to decline as long as more Californians stop smoking.***

continued on next page . . .

REPORT NUMBER 2005-034, JUNE 2006

Board of Equalization's response as of December 2006

Section 22971.1 of the Business and Professions Code (code) requires the Bureau of State Audits to conduct a performance audit of the licensing and enforcement provisions of the Cigarette and Tobacco Products Licensing Act of 2003 (act) and report its findings by July 1, 2006. The code section requires the report to include the following information: (1) the actual costs of the program, (2) the level of additional revenues generated by the program compared with the period before its implementation, (3) tax compliance rates, (4) the costs of enforcement at the various levels, (5) the appropriateness of penalties assessed, and (6) the overall effectiveness of enforcement programs. We found that:

Finding #1: The Board of Equalization uses its analysis of taxes paid to support its position that cigarette tax compliance has improved.

At the request of Board of Equalization (Equalization) management, Equalization's chief economist performed an analysis and estimated that the act generated \$75 million in additional revenues from cigarette sales between January 2004 and March 2006. This estimate is based on Equalization's calculation of an average annual decline in cigarette sales (and by extension, cigarette consumption) of 3 percent over the past 22 years as measured by the number of tax stamps sold, which Equalization calls the tax paid distribution.¹ The 3 percent decline reflects several factors, including fewer people smoking and tax evasion. Equalization's 3 percent decline is consistent with the 2.3 percent average annual decline in smoking prevalence among California adults between 1997 and 2004, based on information published by the Tobacco Control Section of the Department of Health Services.

¹ Equalization's calculation actually showed that the tax paid distribution had decreased by an average of 3.8 percent annually, but for the purposes of its analysis of the effects of the act, it reduced the estimate to the more conservative 3 percent.

- ☑ *In fiscal years 2003–04 and 2004–05, Equalization spent \$9.2 million to implement the provisions of the act, with most of that amount paid toward staff salaries and benefits for licensing and enforcement activities.*
 - ☑ *Equalization imposes penalties in accordance with the provisions of the act.*
-

Equalization assumes that if all factors are equal and the market does not experience major changes, any variations in tax paid distributions are the result of Equalization's implementing the provisions of the act and, after January 2005, its new tax stamp. When Equalization compared its estimate of an annual average decline in cigarette consumption of 3 percent to the change in the rate of sales of cigarette tax stamps since the act went into effect, it found that sales of cigarette tax stamps were greater than it expected based on the historical data. By multiplying the difference in expected sales of cigarette tax stamps and actual stamps sold by the 87 cents cigarette tax rate per pack, Equalization calculated that cigarette tax revenues increased by \$75 million between January 2004 and March 2006. Equalization attributes this to its additional enforcement authorized by the act, although Equalization concurs that the replacement, starting in January 2005, of its old cigarette tax stamp with a new stamp encrypted with a unique digital signature may also play a part.

Rather than relying on cigarette tax stamps sold, we prepared an estimate of the effect of the act using actual revenues collected, and our results were similar to those of Equalization. To determine how the act affected actual collections of cigarette tax revenues, we used Equalization's methodology but replaced the tax paid distributions with the actual cigarette tax revenues that Equalization collected. Our analysis indicates that actual revenues were about \$49 million higher in calendar year 2004 and nearly \$79 million higher in calendar year 2005 compared with the revenues expected for the same years, assuming a 3 percent average annual decline in consumption. The higher collection of cigarette tax revenues in calendar years 2004 and 2005 compared with the expected revenues shows that certain factors were causing the reversal of the historical decline in cigarette tax stamps sold. The smoking prevalence rates among California adults as determined by the Tobacco Control Section of the Department of Health Services for calendar years 2003 and 2004 show declines of 2.4 percent and 4.9 percent, respectively. Therefore, we assume that the increased collections of cigarette tax revenues are the result of increased compliance with cigarette taxes. However, neither Equalization nor we can isolate how much of the increased revenue in calendar year 2005 was the result of the act and how much was the result of the new tax stamp.

Finding #2: Equalization based its \$292 million estimate of cigarette tax evasion on an unrepresentative sample.

In 2003, Equalization estimated that cigarette tax evasion—lost taxes to the State because of illegal sales of counterfeit cigarettes—amounted to \$292 million for fiscal year 2001–02.² However, we believe Equalization's estimate is inflated because it reviewed a sample of retailers that is not

² The term *counterfeit cigarettes* refers to cigarette packs that bear counterfeit tax stamps as well as truly counterfeit products—cigarettes manufactured overseas and patterned after major brands.

representative of all retailers in the State and the number of retailers it used in its calculation of the estimate is overstated. Moreover, Equalization has not updated its tax evasion estimate since 2003 but continues to use that amount as the amount that the State loses each year from cigarette tax evasion.

Equalization attempted to determine the extent of California's counterfeit cigarette problem by having its Investigations Division (Investigations) review roughly 1,300 retailer inspections conducted throughout California between July 2001 and September 2002. Based on the results of the inspections, 25 percent of the State's retailers were selling counterfeit cigarettes, resulting in Equalization's estimate of \$238 million in cigarette tax evasion by retailers that purchase and distribute untaxed cigarettes to consumers. In addition, Equalization estimated that individual consumers evade cigarette taxes totaling about \$54 million each year by purchasing cigarettes over the Internet or by purchasing cigarettes in other states that have lower cigarette taxes. Thus, Equalization estimated that annual cigarette tax evasion totaled \$292 million for fiscal year 2001–02.

Because Equalization's inspectors typically visit stores and areas more likely to exhibit noncompliance—a reasonable approach given its workload and staff—Equalization likely overestimated retailer tax evasion for the entire State. Investigations did not visit major grocery and discount chains, which Equalization pointed out have not historically posed problems with cigarette tax compliance. Additionally, because of limited resources, Equalization focused its inspections on major metropolitan areas. Consequently, the actual percentage of retailers in California that carry counterfeit or untaxed cigarettes is likely less than the 25 percent identified by the inspections, and the amount of cigarette tax evasion Equalization estimated may be overstated.

In addition, the number of retailers Equalization used to estimate cigarette tax evasion appears to be overstated, which also results in an overestimation of the \$238 million in cigarette tax evasion by businesses. Assuming that retail locations that sell alcohol also sell cigarettes, Investigations originally estimated that about 85,000 retail locations in California sold cigarettes, because this was the number of retail locations licensed by the California Department of Alcoholic Beverage Control. However, after passage of the act, only about 40,000 retailers registered as selling cigarettes. Thus, Equalization's original estimate of 85,000 retailers was overstated, although the number of small businesses that stopped selling cigarettes because of the act's licensing requirements may have accounted for a portion of the difference. Using 40,000 as the number of retailers in Equalization's formula results in an estimated amount of cigarette tax evasion by retailers of \$112 million, which is \$126 million less than Equalization's estimate. Since the act was implemented, Equalization has not updated its cigarette tax evasion estimate, even though many of the factors have changed since it prepared its original estimate.

To provide a more accurate estimate of the extent of cigarette tax evasion, we recommended that Equalization update its calculation of cigarette tax evasion using data gathered after implementation of the act.

Equalization's Action: Partial corrective action taken.

Equalization reported that it is developing an updated econometric modeling approach to create an independent estimate of cigarette tax evasion. With its response, Equalization submitted a revised work plan that shows a completion date of May 2007 for this project. Equalization states that the revision will allow it to use the most recent information available from its work related to out-of-state sellers of cigarettes and tobacco products.

Finding #3: The act has had a positive effect on tax revenues from cigarettes and tobacco products.

Collections of cigarette tax revenues fell between fiscal years 2001–02 and 2004–05, although they stabilized at about \$1.025 billion in fiscal years 2003–04 and 2004–05. As we noted previously, the stabilization and reversal of the historical decline in cigarette tax revenue is to some degree the result of the implementation of the act, in addition to the effects of the new cigarette tax stamp. However, collections of cigarette tax revenues will continue to decline as long as more Californians quit smoking.

Collections of the tobacco products surtax have varied from year to year and are not demonstrating a consistent trend. According to Equalization, the tobacco products category comprises several different products, including cigars, snuff, and chewing tobacco, and the market for each product relies on unique demographic and income characteristics. Without the act, Equalization believes that wholesale sales of tobacco products would not have changed from calendar years 2003 to 2004. However, wholesale sales for tobacco products jumped 38.9 percent in calendar year 2004, leading to an estimated \$14 million increase in tax revenue from tobacco products. Because national data do not show an increase in tobacco product sales during that period and Equalization is unaware of any anecdotal evidence demonstrating why the rise occurred, it appears that the most likely reason for the increase is the set of regulatory changes brought about by the act.

Actual revenues for the administrative and license fees that the act instituted were greatest in fiscal year 2003–04, with some collections occurring in fiscal year 2004–05. The administrative fee is a one-time fee that will continue to generate some revenue as new manufacturers and importers qualify to do business in California. In addition, a modest amount of revenue will continue to be realized from distributors and wholesalers paying the \$1,000 annual renewal fee. Also, a retailer that changes ownership or opens a new sales location must obtain a license and pay the license fee. Collections of fines assessed on civil citations do not currently play a large role in total revenues, but may increase over time.

Finding #4: Costs of carrying out the provisions of the act largely comprise staff salaries and benefits.

In fiscal years 2003–04 and 2004–05, Equalization spent \$9.2 million to implement the provisions of the act, with most of that amount paid toward staff salaries and benefits. A large portion of the costs in the first two years were for enforcing the provisions of the act, although licensing activities and overhead costs to make programming changes to Equalization’s information systems were a large proportion of costs that Equalization incurred in fiscal year 2003–04.

Finding #5: In addition to having a reasonable investigative process, Equalization imposes penalties in accordance with the act.

Investigations has a clearly defined and reasonable process for conducting inspections and investigations relating to cigarettes and tobacco products. Furthermore, the Excise Taxes and Fees Division (Excise Taxes) has documented and Equalization’s five-member board (board) has approved procedures to assess penalties in accordance with the provisions of the act. Based on our testing of felony investigations and inspection citations, we determined that Investigations and Excise Taxes follow the procedures for conducting inspections and investigations, issuing citations, and assessing penalties for civil citations. By following board-approved procedures, Equalization can maintain case-to-case consistency and ensure that it is enforcing the provisions of the act.

DEPARTMENT OF SOCIAL SERVICES

In Rebuilding Its Child Care Program Oversight, the Department Needs to Improve Its Monitoring Efforts and Enforcement Actions

Audit Highlights . . .

Our review of the Department of Social Services' (department) oversight of licensed child care facilities found that the department:

- Has struggled to make required visits to the facilities and carry out its other monitoring responsibilities.*
- Began a three-phase effort in 2005 to rebuild its oversight activities for its licensing programs.*
- Usually conducted complaint visits within established deadlines but did not always complete the investigations within deadlines.*
- Did not always determine whether child care facilities corrected the deficiencies it identified during its visits to facilities.*
- Could increase its use of civil penalties as a response to health and safety violations.*
- Appropriately prioritized and generally ensured that legal cases were processed within expected time frames; however, its regional offices did not always adequately enforce legal actions against licensed child care facilities.*

REPORT NUMBER 2005-129, MAY 2006

Department of Social Services' response as of November 2006

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits to review the Department of Social Services' (department) oversight of licensed child care facilities. Specifically, the audit committee requested that we assess the department's progress in meeting facility inspection requirements and determine whether the department's authority and resources were adequate to fully enforce the required health and safety standards in child care facilities. Additionally, we were asked to review the department's process for investigating and resolving complaints regarding facilities. Further, the audit committee asked us to examine the department's policies and procedures for categorizing health and safety risks identified at child care facilities and to review the reasonableness of the department's processes and practices for informing parents of problems it had identified. Finally, the audit committee requested that we review the disciplinary process the department uses when it identifies deficiencies in facilities.

Finding #1: The department has struggled with making periodic inspection visits required by statutes, and the data it uses to track these visits are not sufficiently reliable.

State law enacted in August 2003 established new requirements for how often the department should conduct periodic inspections of child care facilities. Under this new law, the department annually must make required visits to certain facilities and random visits to at least 10 percent of the remaining facilities. The requirements further state that the department must visit each child care facility at least once every five years, which means that it would conduct visits, on average, of approximately 20 percent of the facilities annually.

However, we found that the department did not meet those statutory requirements for fiscal year 2004–05, the only full year that had elapsed since the requirements were enacted. Specifically, the department performed 68 percent of the required or random visits needed for fiscal year 2004–05. In addition, these visits represented only 8.5 percent of the licensed child care facilities in the State during the same period.

Further, the department had yet to start tracking the “once every five years” requirement to determine the facilities it needs to visit so it can ensure that all are visited within the five-year period. Moreover, we found that the data the department uses to record and track inspection visits were not sufficiently reliable. For example, we found in the data numerous instances of multiple visits being made to the same facility on the same day. As a result of these and other problems, the data may not accurately reflect the department’s progress toward meeting statutory requirements.

We recommended that the department develop a plan to measure its random and required visits against its statutory requirement to visit each facility at least once every five years, assess its progress in meeting this and other statutory requirements, and ensure that the data it uses to assess its progress in meeting the various requirements are sufficiently reliable.

Department’s Action: Partial corrective action taken.

The department has developed an information technology strategic plan to provide systems and tools to eliminate or mitigate problems identified in the audit, such as for measuring its random and required visits. While the department seeks approval of its technology plan and explores methods for obtaining additional resources, it is using interim solutions. In particular, it stated that it has developed special reports to identify child care facilities that have not received a visit and the number of facilities visited each fiscal year. In addition, the department stated that it has taken efforts to improve the accuracy of the data maintained in its systems. For example, the department completed a project that allowed automated field data to be electronically shared with its licensing information system. Finally, the department stated that it would continue its efforts to prevent any duplication of information.

Finding #2: Although the department has recently begun rebuilding its oversight operations, much more remains to be done.

In the spring of 2005 the department’s community care licensing division initiated a significant effort to rebuild its operations in three phases. The rebuilding effort is intended to increase and improve the department’s oversight of its licensing programs, including the child care program. The first two phases focused on rebuilding the “foundation” of the monitoring program, hiring staff, and increasing the department’s monitoring and enforcement activities. At the time of our review, the department had yet to fully develop plans for Phase III, which it envisioned as a time to analyze the increased information it will have gathered and to determine any follow-up or modifications needed. However, as the department continues its rebuilding efforts, a question for the State’s decision makers to consider is whether the level of monitoring that the department is working toward is sufficient to ensure the health and safety of children in child care facilities.

In addition, although the department has some existing methods and has started to implement others to help it monitor the activities of its regional offices, it has yet to develop the automated management information that will allow it to effectively perform this monitoring. Further, even though the department has established a process to inform parents of certain deficiencies it has identified at child care facilities, it has yet to make nonconfidential information about its monitoring visits to facilities readily available to the public. The department has expressed its intent to put all nonconfidential information on its Web site, but stated that implementation will be dependent on funding.

We recommended that the department continue its efforts to rebuild the oversight operations of its child care program and assess the sufficiency of its current monitoring efforts and statutory requirements to ensure the health and safety of children in child care facilities. In addition, the department should develop sufficient automated management information to facilitate the effective oversight of its child care program regional offices. Further, the department should continue its efforts to make all nonconfidential information about its monitoring visits more readily available to the public.

Department's Action: Partial corrective action taken.

As part of the department's efforts to ensure the health and safety of children in child care facilities, the department stated it contracted with the University of California, Davis (UCD) to conduct a nationwide literature review about the frequency of inspection visits, caseloads, and measures that reduce risk and increase safety. A draft of the literature review is currently under review by the department. According to the department, it then plans to select certain studies for additional research by UCD. In addition, the department stated that it convened a team to evaluate how it could best oversee the effectiveness of its monitoring and enforcement activities. In addition to recognizing the importance of automated management information, the team recommended that the department develop a quality control function. Further, the department stated that child care program regional offices plan to conduct self-assessments, and the child care systems analyst will conduct reviews of the 12 regional offices over the next two years. Finally, as part of its strategic plan the department has begun to evaluate the options to consider for public access to information. However, the department stated that development and implementation of a web-based application depends on additional resources.

Finding #3: The department could improve its handling of complaint investigations.

Of the 40 complaint investigations we reviewed, the department completed eight outside its established 90-day deadline, ranging from 39 to 247 days late. In addition, our review of 54 complaint allegations the department deemed inconclusive revealed that in 19 instances it could have taken additional action to determine that the allegations were substantiated or unfounded. Further, we found little guidance in the department's evaluator manual about the actions the department should take in these instances. The department stated that its training in April 2006 was to include exercises designed to help new analysts evaluate evidence and reach conclusions on complaint allegations. At the time of our review, the department also planned to hold advanced complaint training for all child care licensing staff.

The department considers a complaint investigation complete when a supervisor approves the investigation. In six of its regional offices, the approval occurs after an analyst submits the investigation's findings but before corrective action is taken. The remaining six regional offices are taking part in a pilot project in which the approval occurs after the facility's plan of correction has been completed. However, the department has not yet determined which method of supervisory approval it intends to implement statewide.

Our review in one regional office of the department's complaint specialist pilot project, which it implemented in July 2005, disclosed several instances in which the department did not ensure that it took timely and appropriate action to enforce serious health and safety violations. For example, the department had taken follow-up action for only two of the seven facilities we reviewed since the complaint investigations were completed.

We recommended that the department complete complaint investigations within the established 90-day period, revise its policies to identify specific actions its child care program staff could take to reduce the number of inconclusive complaint findings, and continue its plans to train all of its analysts in evaluating evidence and reaching conclusions on complaint allegations. In addition, we recommended that the department evaluate its pilot project for supervisory approval after the plan of correction has been completed and implement a consistent process statewide for ensuring that licensees take appropriate corrective action. Further, the department should review the complaint specialist pilot project in its regional offices and use the results of its review to determine how it should modify its existing processes.

Department's Action: Partial corrective action taken.

The department reported that it reviewed the 90-day goal for completing investigations and believes the goal is reasonable. However, its review highlighted the need for valid automated management information to plan, track, and assess how well it is doing in meeting the 90-day goal. In addition, the department stated that it reviewed preliminary data on the findings of complaint investigations and found that about 30 percent were inconclusive, which was consistent with a past study. The department stated that it plans to review complaint data by regional office and will continue to study the possibility of reducing the number of inconclusive findings. Also, the department stated that it conducted advanced complaint training for its child care program managers in September 2006, and it has scheduled the training for child care program analysts. Further, according to the department, data from its pilot project about supervisory approval indicated that the most effective and timely method of supervisory approval for complaint investigations occurs before corrective action is taken. As a result, the department plans to institute the process statewide. Finally, the department reviewed its complaint specialist pilot project and stated that the time taken to investigate these serious complaints was shortened by 10 days. Nevertheless, it has established two workgroups, one of which has identified best practices and specified suggested improvements in a report to the department.

Finding #4: The department did not always determine that facilities corrected deficiencies identified during its visits, and often its prescribed corrective action was not verifiable.

Our review found that the department did not always determine whether facilities had corrected the deficiencies arising from complaint, random, and required visits. For example, we found no evidence in the facility files that the department had determined whether deficiencies were corrected for 32 (25 percent) of 127 deficiencies the department cited from random and required visits. The department requires facilities to correct deficiencies within 30 days of being cited unless it determines that more time is needed. However, of the 95 deficiencies the department determined were corrected, we found that 31 were corrected more than 30 days after the department issued the citations. In addition, we identified various instances in which the plan of correction was not written in a way that the department could verify or measure the corrective action the facilities had agreed to take. Thus, the department did not always have ongoing assurance that the deficiencies had been corrected.

We recommended the department ensure that deficiencies identified during its monitoring visits are corrected within its established 30-day time frame, that evidence of corrective action is included in its facility files, and that required plans of correction submitted by facilities are written so that it can verify and measure the actions taken.

Department's Action: Partial corrective action taken.

In an effort to ensure that deficiencies identified during monitoring visits are corrected within the established time frame, the department stated that it evaluated various methods for follow-up, procedures for granting extensions, and tools available to field staff in managing caseloads and tracking deadlines. In addition, the department stated that it is working to modify its evaluator manual to clarify areas of ambiguity and inconsistency related to plans of correction. Further, it stated that the information technology strategic plan includes automated enhancements that will assist field staff in monitoring the completion of plans of correction to ensure that follow-up occurs. Finally, the department evaluated its current activities and determined it needs to develop additional training to ensure that plans of correction submitted by facilities are written so that it can verify and measure the actions taken.

Finding #5: The department could increase its use of civil penalties as an enforcement tool.

Our review found that the department could increase its use of civil penalties as a response to health and safety violations by child care centers (centers) and family child care homes (homes). In particular, we found that the department did not assess civil penalties against homes in many instances we reviewed because the regulations for homes prescribe a more limited use of civil penalties for violations than the regulations for centers do. Further, our review of selected centers and homes found that the department did not always assess civil penalties for repeat violations, even though laws and regulations require it. Moreover, the department's evaluator manual prohibits civil penalties from being assessed if a follow-up visit is not conducted within 10 working days of the date specified for corrections to be made. However, the department is not precluded from conducting subsequent visits to previously cited facilities and citing them for repeat violations of the same regulations within a 12-month period. Nevertheless, we found several instances in which the department might have assessed civil penalties but did not because it did not make any follow-up visits.

We recommended that the department ensure that it assesses civil penalties in all instances where state laws and regulations require it. Additionally, it should consider proposing statutes or regulations requiring it to assess civil penalties on homes for additional types of violations. Further, the department should consider seeking changes to the requirement that it cannot assess civil penalties if follow-up visits are not conducted within 10 days of the time that corrective action was taken.

Department's Action: Partial corrective action taken.

The department stated that it proposed a "zero tolerance" policy that was included in a bill that would require civil penalties to be assessed for certain high-risk violations. The bill was considered by the Legislature in 2006 but did not pass. In addition, the department stated that it issued memos to department and county licensing staff in September 2006 that describe the statutes and policies requiring the assessment of civil penalties. At the same time, it developed and distributed to county licensing staff a civil penalty manual about the use of civil penalties. Further, the department stated it plans to modify the evaluator manual to further clarify the use of civil penalties. Finally, the department stated that it has not yet completed its review and evaluation about the requirement that follow-up visits be made within 10 days of the plan of correction date for civil penalties to be assessed.

Finding #6: The department has not consistently followed its guidance about using noncompliance conferences.

Our review of a sample of child care facilities at four regional offices revealed several instances in which the department did not follow guidance provided in a May 2004 memorandum about the use of noncompliance conferences to gain compliance from its licensees. For example, contrary to the May 2004 memorandum's requirements, the department did not require noncompliance conferences to be held after the initial citation for seven of 12 facilities we reviewed. In addition, we found that the department did not always conduct the noncompliance conferences promptly, given the severity of the noncompliance. In particular, the department took between two and five months to hold noncompliance conferences for five of 18 facilities we reviewed. Further, we identified instances in which the department's regional offices were inconsistent about the timing of noncompliance conferences. For example, one regional office required a licensee to attend a noncompliance conference 23 days after an incident occurred, whereas another regional office did not require a licensee to attend a noncompliance conference until nearly five months after an incident occurred.

We recommended that the department clarify its direction to regional office staff to help ensure that they are using noncompliance conferences promptly and in appropriate instances. Additionally, the department should reevaluate its May 2004 memorandum and, to the extent it reflects the department's current intent, incorporate the guidance into its evaluator manual. Further, the department should periodically review regional offices' use of noncompliance conferences to ensure that they are consistently following established policies.

Department's Action: Partial corrective action taken.

The department stated that it established a team to review its policies and directives involving noncompliance conferences. According to the department, the team determined that the evaluator manual provided the most complete guidance. However, the team found that the manual needs improvement. Therefore, the team recommended that the department focus on updating and improving the evaluator manual, including incorporating the directives from its May 2004 memorandum. In addition, the team recommended that the department revamp the noncompliance conference requirements in some instances. Further, the department agreed adherence to the noncompliance conference procedures should be part of its quality control efforts.

Finding #7: The regional offices may not always consult legal staff as early as possible.

The department's evaluator manual states that situations involving physical or sexual abuse or ones in which there is an imminent risk to children should be referred immediately to the legal division. In addition, the manual states that regional offices should consult with their legal staff in cases in which the regional office is unsure as to whether legal action is warranted. However, we noted some cases that caused us to question whether regional offices are consulting the legal division as early in the process as would be beneficial. The department acknowledged the need to use legal consultants more effectively by implementing in January 2006 a pilot project in Southern California to provide staff with more immediate access to legal consultants.

We recommended that the department ensure that regional office staff consult with legal division staff early in the process when circumstances warrant it by clarifying its policies as necessary and following up to determine that the policies are complied with.

Department's Action: Partial corrective action taken.

According to the department, preliminary data from the informal survey on its legal division's early consultation pilot project indicated that regional managers in Southern California were generally positive about the project. The department stated that its legal division was considering whether to expand the pilot project. Even if the project is not expanded, the department stated that it has stressed to all levels of licensing management the need for early as-needed consultations with legal division staff.

Finding #8: The department's enforcement of legal actions continues to need improvement.

Our review of 28 legal cases—15 in which the facility's license was revoked and 13 in which facilities were placed on probation—found that regional offices did not always adequately enforce legal actions against licensed child care facilities. Specifically, we found that as of March 2006, the department had not made visits to 12 of the 15 facilities that had their licenses revoked, although it had been longer than the required 90 days in each instance. In addition, we found that the department did not make follow-up visits to two of the 13 facilities placed on probation.

The department's policies require it in some instances to exclude employees or adult residents from the facilities and require the regional office to verify at the next evaluation visit that the licensee is complying with the exclusion order. Three cases we reviewed required the department to exclude employees or adult residents from the facilities. In the three cases, the regional office did not promptly make visits to the facilities to ensure the licensee's compliance. For example, the regional office did not conduct a visit for one of the three cases until nearly a year after the exclusion order became effective.

We recommended that the department require follow-up monitoring visits to ensure that child care facilities with revoked licenses are not operating and that individuals excluded from facilities are not present in the facilities. In addition, we recommended that the department ensure that visits to facilities on probation are made within the required deadline. Further, the department should revise its policies for following up on excluded individuals to ensure that it more promptly verifies that they are not present in facilities.

Department's Action: Partial corrective action taken.

The department reported that a team it established has reviewed findings about the failure to ensure that child care facilities with revoked licenses cease operation and that excluded individuals are removed from facilities. The team concurred that follow-up must occur. The department plans to revise the evaluator manual to make this requirement clear. However, the team determined that a follow-up visit is not always necessary to verify the closure of a facility or the absence of an individual. In such instances, the department stated that a licensing supervisor must approve when a visit is not necessary, and the determination should clearly be documented in the case file. The department also stated that its evaluator manual should be revised to identify the documentation requirements. Further, the team recommended that the department verify within 30 days that an excluded individual has left a facility. With regard to facilities on probation, the department issued a memorandum in July 2006 to remind licensing staff of the evaluator manual requirements about follow-up visits. In addition, the department stated that it has decided to treat monitoring visits to facilities on probation similar to the priority given to its complaint visits. Finally, according to the department, its information technology strategic plan includes enhancements to allow for automated tracking and notification for follow-up visits to facilities with either revoked licenses or excluded individuals or facilities that are on probation.

CALIFORNIA STUDENT AID COMMISSION

Audit Highlights . . .

Our review of the California Student Aid Commission (Student Aid) and EDFUND'S administration of the Federal Family Education Loan (FFEL) Program revealed the following:

- Changes in federal laws governing the FFEL Program raise doubts that the State will be able to sustain the program.*
 - Ongoing tensions between Student Aid and EDFUND have hampered Student Aid's ability to renegotiate a revenue agreement with the U.S. Department of Education, which may have cost the State at least \$24 million in federal fiscal year 2005. These tensions also have delayed attempts to expand and diversify EDFUND's financial services.*
 - Student Aid approved sizeable bonuses for EDFUND executive staff even when the FFEL Program had an operating deficit.*
 - Student Aid has maintained poor oversight over EDFUND. For example, Student Aid has not ensured that EDFUND travel and business policies are fiscally conservative, which results in less funding available to Student Aid to fulfill its mission.*
-

Changes in the Federal Family Education Loan Program, Questionable Decisions, and Inadequate Oversight Raise Doubts About the Financial Stability of the Student Loan Program

REPORT NUMBER 2005-120, APRIL 2006

California Student Aid Commission's response as of December 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review California Student Aid Commission's (Student Aid) governance and oversight of its auxiliary organization, known as EDFUND, including EDFUND's financial management and business practices. The audit committee was interested in ensuring the proper use of state assets in maximizing support for financial aid purposes.

Finding #1: Federal changes will affect Student Aid's ability to earn surplus funds from the FFEL Program.

Student Aid's ability to generate an operating surplus from the Federal Family Education Loan (FFEL) Program will be affected significantly by a change required under the Federal Higher Education Reconciliation Act of 2005 (Reconciliation Act) contained in the Federal Deficit Reduction Omnibus Reconciliation Act of 2005. How Student Aid and its competitors choose to implement one change in particular ultimately could determine whether the State should continue to participate as a guaranty agency in the FFEL Program. The change requires guaranty agencies to charge borrowers a 1 percent federal default fee on the principal amount of all FFEL Program loans issued after July 1, 2006, and deposit the proceeds into the Federal Student Loan Reserve Fund (Federal Fund) or transfer an equal amount from nonfederal sources into the Federal Fund. Guaranty agencies with sufficient resources can elect to pay the fee on behalf of borrowers, while agencies with limited resources, such as Student Aid, will have to charge borrowers the fee. These guaranty agencies will be at a distinct competitive disadvantage and may experience a reduction in their market share.

EDFUND staff performed two analyses to determine the impact on FFEL Program operations depending on whether or not other guaranty agencies elect to pay the federal default fee on behalf of borrowers. However, EDFUND's legal counsel asserts that these analyses are confidential and proprietary. Thus, we cannot discuss the specific details of the analyses. Nevertheless, recent announcements by some of the other guaranty agencies indicate that they will not charge borrowers the fee. Conversely, Student Aid has announced it would charge borrowers the fee.

Because of the recent announcements by other guarantors, it will be necessary for EDFUND to revise its forecasts for federal fiscal years 2006 and 2007. It is our belief that FFEL Program revenues could be reduced to the point where EDFUND's role as an auxiliary organization assisting Student Aid in administering the program is no longer warranted. EDFUND states that it has many tactics to minimize the impact of any changes in its competitive position. These tactics include strategies it and other guarantors in the industry use to maintain effective relations with and competitive services for schools, and to work with lenders to strike new relationships that include payment of the default fee. However, EDFUND cannot determine what, if any, impact these tactics will have on its ability to remain competitive in the student loan guaranty market.

The Reconciliation Act imposes other changes that likely will reduce Student Aid's FFEL Program revenues. Specifically, on or after October 1, 2006, the Reconciliation Act prohibits guaranty agencies from charging borrowers collection costs that exceed 18.5 percent of the outstanding principal and interest of a defaulted loan that is paid off through consolidation by the borrower. It also requires the agencies to remit to the U. S. Department of Education (Education) 8.5 percent of the collection charge. Effective October 1, 2009, the Reconciliation Act will require guaranty agencies to remit to Education the entire amount of collection costs for each defaulted loan that is paid off with excess consolidation proceeds, which are the proceeds of consolidated defaulted loans that exceed 45 percent of the guaranty agency's total collections on defaulted loans in each federal fiscal year. Because it has relied so heavily in the past on using consolidations to collect on defaulted loans, these changes will almost certainly result in a decrease to the portion of Student Aid's net recoveries on loan defaults that result from this collection method. Although these changes in federal law do not become operative until federal fiscal year 2010, according to EDFUND it is aggressively reducing its use of consolidations to collect on defaulted loans.

To manage the FFEL Program in a manner that benefits the State, we recommended that Student Aid continue to reassess the financial impact on the FFEL Program caused by changes in the federal Higher Education Act and the recent announcements made by some large guaranty agencies that they will pay the federal default fee for borrowers. Additionally, Student Aid should monitor EDFUND's progress toward reducing its reliance on defaulted loan consolidations.

To determine if it remains beneficial for the State to participate in the FFEL Program as a guaranty agency, we recommended that the Legislature closely monitor Student Aid and EDFUND to ensure that they are able to remain competitive with other FFEL Program guaranty agencies.

Additionally, we recommended that the Legislature closely monitor the Student Loan Operating Fund (Operating Fund) to ensure that the FFEL Program is generating a sufficient operating surplus so that it can supplement funding for Student Aid's other services and programs. If it is unable to generate a sufficient operating surplus, the Legislature should require Student Aid to dissolve EDFUND and contract with another guaranty agency to administer the FFEL Program. The contract should include, among other things, a provision that allows Student Aid to receive a share of the revenues generated by the guaranty agency, which then could be used to supplement

funding for Student Aid's other financial aid programs. In addition, the contract should include a provision for Student Aid to hire external auditors to ensure that the guaranty agency is complying with federal laws and regulations. Alternatively, the Legislature could reconsider the need for a state-designated guaranty agency.

Student Aid's Action: Partial corrective action taken.

Student Aid stated that many large lenders have decided to pay the federal default fee for the remainder of the academic year (October 1, 2006 through September 30, 2007) on behalf of borrowers whose loans it guarantees. However, Student Aid was unable to provide us with documentation to support this statement. Specifically, Student Aid stated that it does not require any legal documents such as contracts or agreements from the lenders specifying their commitment to pay the fee and the circumstances under which they will pay the fee for the borrower. Student Aid also stated that it and EDFUND are actively pursuing a multi-year default fee strategy for new loans guaranteed after July 1, 2007.

Further, Student Aid stated that EDFUND is projecting significant increases in revenues net of expenses for the federal fiscal year 2007 budget and annual forecasts through federal fiscal year 2011. According to our review of EDFUND's unaudited data, on average, roughly 25 percent of its projected increases are the result of a change to the federal law that is aimed at expanding graduate and professional student borrowing, which took effect on July 1, 2006.

Finally, Student Aid stated that EDFUND's chief financial officer regularly reports financial data to its staff, commissioners, and the EDFUND board. Our review of EDFUND's unaudited data found that it has shifted its collection strategy and has moved away from a focus on consolidations.

Legislative Action: Unknown.

Finding #2: Tensions between Student Aid and EDFUND have delayed critical activities, resulting in lost revenue.

The inability of Student Aid and EDFUND to agree on the role of each organization and the general lack of cooperation between the two has hampered efforts to renegotiate an important agreement with Education that may have resulted in a lost opportunity to receive at least \$24 million in federal fiscal year 2005. Further, these same problems have hindered attempts to expand the financial aid services provided by EDFUND, thereby preventing it from generating additional revenues that could have been used for students. Finally, Student Aid and EDFUND have yet to clarify the roles and responsibilities of each organization despite several attempts to do so.

Student Aid failed to renegotiate its voluntary flexible agreement (VFA) with Education in a timely manner. Disputes between Student Aid and EDFUND, along with turnover in EDFUND's executive management team, have contributed to delays in Student Aid's submission of a VFA proposal to Education. In federal fiscal year 2005, EDFUND budgeted \$30 million in VFA revenues. However, it received only \$6 million. According to Education's state agency liaison, he informed Student Aid and EDFUND in June 2004 that they would not receive any VFA funding beyond federal fiscal year 2004 until the agreement was renegotiated to obtain cost neutrality. Thus, Student Aid may not be able to receive the additional \$24 million that EDFUND budgeted

for federal fiscal year 2005 or any other funds it may have been eligible to receive. If Education and Student Aid are unable to complete their renegotiations and comply with the VFA requirements before September 30, 2006, Student Aid also risks losing the opportunity to receive the \$31.4 million that EDFUND budgeted for federal fiscal year 2006.

As discussed previously, federal changes will affect Student Aid's ability to earn surplus funds from the FFEL Program. Thus, the State's ability to continue to generate sufficient FFEL Program revenue to support its other programs and services may rely upon Student Aid's and EDFUND's ability to obtain additional sources of revenue from a diverse set of student loan-related business activities. Currently, neither Student Aid nor EDFUND has a formal plan that specifically identifies the business diversification opportunities they will target.

Student Aid and EDFUND also do not agree on the appropriate role each should have in the administration of the FFEL Program. Despite attempting to craft a roles and responsibilities document (document) since at least May 2005, they have yet to finalize one. Furthermore, based on our review of the ninth version of the two-page draft document, Student Aid may be inappropriately ceding some of its responsibilities to EDFUND. For example, it states that EDFUND has the primary role in operating all aspects of the FFEL Program. However, federal law requires the guaranty agency that chooses to delegate the performance of the FFEL Program function to another entity to ensure that the other entity complies with the program requirements and to monitor its activities. In addition, federal regulations require the state agency to maintain full responsibility for the operation of the FFEL Program when the program is administered by a nonprofit organization.

We recommended that the Legislature closely monitor Student Aid's progress toward completing critical tasks, including the renegotiation of its VFA with Education and the development of a business diversification plan. Student Aid should ensure that critical tasks, including the renegotiation of its VFA with Education and the development of a diversification plan, are completed. Student Aid should also ensure that the roles and responsibilities it delineates for itself and EDFUND do not inappropriately cede its statutory responsibilities to EDFUND.

Student Aid's Action: Partial corrective action taken.

Student Aid stated that as of December 8, 2006, it and Education had not renegotiated a new VFA. Student Aid also stated that it, the EDFUND board, and California administrative officials are aware of the ongoing efforts by the EDFUND president to renegotiate and finalize the new VFA. In addition, Student Aid stated that its commissioners and EDFUND board members agreed that available capital should be used to invigorate core guarantee business because this focus could produce greater and more immediate revenue returns. However, according to Student Aid, it also agreed that EDFUND would continue to be alert to potential opportunities to partner with other entities and to present these options to Student Aid. Finally, Student Aid hired a consultant in November 2006 to assist it in further delineating the roles and responsibilities between it and EDFUND.

Legislative Action: Unknown.

Finding #3: Student Aid's process for establishing executive salaries and bonuses for EDFUND requires improvement.

EDFUND created its current policy for setting executive salaries in response to federal regulations ensuring reasonable compensation for employees who exercise substantial control over nonprofit corporations. Under the regulations, payments under a compensation arrangement are presumed to be at fair market value if the arrangement is approved in advance by an authorized body of EDFUND composed of individuals without a conflict of interest, the authorized body obtained and relied upon appropriate comparability data, and the body adequately documented its basis for determination. Adequate documentation consists of the terms, approval date, members of the authorized body present, members who voted, comparability data and how it was obtained, and any actions taken with respect to consideration of the transaction by anyone who is a member of the body but who had a conflict of interest. However, EDFUND's policy does not address board members who have a conflict of interest. In addition, we question the manner in which EDFUND carried out its salary comparison. Specifically, although EDFUND uses surveys to assist in establishing salaries for its executives, it does not limit data to survey sources related to the financial industry. Furthermore, EDFUND cannot demonstrate that it follows its executive salary determination policy because the board and executive committee have not kept sufficient minutes of their meetings.

Student Aid's policy regarding EDFUND executive incentive compensation is also flawed. The operating agreement between Student Aid and EDFUND specifically states that EDFUND agrees to administer its executive performance payment plan in accordance with the Student Aid policy statement and guidelines memo (policy) titled *EDFUND Incentive Compensation Plans*, dated August 12, 2002.

This policy contains flaws because it allows bonuses when an operating deficit exists and excludes some FFEL Program revenues and expenses from the calculation of the Operating Fund surplus or deficit. In addition, the policy is completely discretionary and is silent on how EDFUND should determine the amount of the executive compensation pool. Finally, the policy directs the board to recommend the proposed bonus amounts, if any, for the president and the total bonus amount for the vice presidents. However, the board does not appear to use consistent criteria from one year to the next when determining the total bonus amount.

We recommended that Student Aid ensure EDFUND complies fully with federal regulations and its policy governing salary setting for its executives, including modifying its policy to address board members who have a conflict of interest and ensuring that its consultants compile comparable compensation data solely from similar financial-related organizations. Student Aid should also ensure that EDFUND determines bonuses for its president in accordance with Student Aid's policy. Further, Student Aid should modify its policy statement and guidelines memorandum titled *EDFUND Incentive Compensation Plans* to ensure that EDFUND includes all FFEL Program revenues and expenses in its calculation of the program's operating surplus or deficit and that EDFUND's executive management team does not receive a bonus if the FFEL Program or Operating Fund realizes a deficit. Finally, Student Aid should ensure that it and EDFUND's board establish guidelines to use when approving the total bonus pool amount for EDFUND's executive management team.

Student Aid's Action: Partial corrective action taken.

EDFUND's Personnel, Evaluation, and Nominations (PEN) Committee developed a draft comprehensive executive compensation policy that incorporates the general principles recommended by the consultant hired to assist it with the evaluation of the existing policy. Student Aid stated that the EDFUND board would review and approve the draft policy by February 2007 and forward it to Student Aid's PEN Committee and commissioners for approval. Student Aid also stated that EDFUND has retained legal counsel to determine whether or not the draft policy fully complies with all applicable federal and state regulations.

According to Student Aid, it used the same consultant hired by EDFUND to review its policy statement and guidelines memorandum titled EDFUND Incentive Compensation Plans and recommend changes. Student Aid stated that the EDFUND board would review and approve its draft policy statement and guidelines by February 2007 and forward it to Student Aid's PEN Committee and commissioners for approval.

Finding #4: The method used to determine nonexecutive bonuses needs to be reevaluated.

Student Aid has not fully addressed concerns raised by an assessment of EDFUND's accomplishment of performance goals. EDFUND has three bonus plans for nonexecutive employees, known as variable pay plans. Two of its three plans reward employees for both individual performance within and the overall performance of EDFUND as an organization, while the third plan is a straightforward award based on a percentage of monthly collections of defaulted loans. Organization performance goals are determined through a process outlined in the August 2002 Student Aid policy. EDFUND uses several high-level organizational metrics to measure its performance of the goals set by Student Aid.

Although its executive director has raised several concerns regarding EDFUND's method of calculating organizational performance, Student Aid has done little to fully address the issues. The executive director and president have agreed that four issues must be addressed: whether and how to recognize goals not achieved, whether and how to recognize a percentage of accomplishment above the assigned weights, whether to set a standard for acceptable variance to a goal, and how midyear budget changes may affect a goal. However, as of March 2006, little progress has been made to resolve these issues. Until these outstanding issues are resolved, EDFUND will continue to award bonuses that are not based on an accurate assessment of its organizational performance.

We recommended that Student Aid direct its executive director and EDFUND's president to resolve outstanding issues related to the methodology used to measure EDFUND's performance, which affects the bonuses for its nonexecutive employees.

Student Aid's Action: Partial corrective action taken.

Student Aid stated that the commission's executive director and EDFUND's president have reached agreement on EDFUND's federal fiscal year 2006 performance goals except for one issue that addresses the credit to be given for the turnover rate and recovery rate metrics.

Finding #5: More funds would have been available if Student Aid had required EDFUND to follow more fiscally conservative policies.

Student Aid has not ensured that EDFUND policies are fiscally conservative. Further, EDFUND does not always comply with its business and travel expense policies. We also found a few instances in which Student Aid did not comply with the State's travel policy. Finally, EDFUND spent almost \$700,000 over five federal fiscal years from the Operating Fund for 14 events, such as holiday receptions, employee conferences, and workshops and meetings, that we reviewed. These events often included lodging and meals at upscale hotels and resorts for high-level staff, expensive guest speakers and entertainment. We also found several instances when EDFUND hosted and paid for an event and allowed family members to attend without paying their own way. We question how spending large sums of money on these type of events supports the State's mission of assisting students in achieving their educational goals.

We recommended that Student Aid amend its operating agreement to require EDFUND to establish a travel policy that is consistent with the State's policy. Additionally, it should closely monitor EDFUND expenses paid out of the Operating Fund for conferences, workshops, all-staff events, travel, and the like. Finally, it should ensure that EDFUND discontinues using Operating Fund money to pay for expenses related to nonemployees attending its company functions.

Student Aid's Action: Corrective action taken.

On September 7, 2006, Student Aid approved EDFUND's revised travel policy, which became effective on October 1, 2006. The travel policy adopts by reference the State's short-term travel reimbursement for all exempt, excluded, and represented employees. However, the travel policy includes certain exceptions such as EDFUND's use of the U.S. Internal Revenue Services' per diem rates for meals and incidental expenses and its allowable rate for personal vehicle mileage. According to EDFUND, these exceptions were necessary to reflect its status as a nonprofit public benefit corporation and its need to remain competitive with similar corporations in the industry.

Also, on September 7, 2006, Student Aid approved EDFUND's new employee-wide events spending policy, which became effective on October 1, 2006. The spending policy requires EDFUND to prohibit the use of corporate funds for employee-wide benefits, except as approved by its board. However, Student Aid approved the policy with the understanding that EDFUND's annual budget should reflect a separate line item to highlight any funds to be used for employee-wide events. Finally, EDFUND's spending policy prohibits it from using corporate funds to subsidize the costs of guests participating in its employee-wide events.

Finding #6: EDFUND did not always comply with its contracting policies.

EDFUND's contracting policies are vague, leading to lack of guidance in contracting procedures, frequent issues of noncompliance, and questionable practices. EDFUND's policy requires its staff to procure goods and services using one of three methods—competitive bid, sole- and single-source procurement, and an urgency provision for sole-source contracts that are greater than \$100,000. In addition, the policy states that all procurements greater than \$10,000 require at least three bids unless documentation exists indicating three viable vendors decline to bid or are not available. Staff also must provide a justification memorandum or bid/cost analyses approved by an assistant vice president or someone in a higher position.

For 15 of the 16 contracts tested, we found violations ranging from lack of documentation to inadequate sole-source justification. For example, our review of 16 contracts found that EDFUND did not ensure that staff obtained the three bid and cost analyses requirement for 11 contracts exceeding \$10,000. Furthermore, although EDFUND's policy requires staff to submit a justification memorandum with procurements under its competitive bid and single- and sole-source methods, it provides no guidance on what the memo or analysis should include. EDFUND's assistant general counsel acknowledges that its policy requires revision and stated that it is working toward doing so.

Finally, the operating agreement between Student Aid and EDFUND does not specifically require purchases of goods and services incurred by EDFUND to be reimbursed pursuant to a procurement and contracts policy approved by the executive director of Student Aid. Without such a provision, the State cannot ensure that EDFUND's purchases result in costs that are appropriate and reasonable.

We recommend that Student Aid amend its operating agreement to require purchases of goods and services incurred by EDFUND to be reimbursed pursuant to procurement and contracting policies approved by the executive director of Student Aid. Student Aid should also ensure that EDFUND follows through on its efforts to revise its contracting policies.

Student Aid's Action: Corrective action taken.

On September 7, 2006, Student Aid approved EDFUND's revised procurement/contracts policy, which became effective on October 1, 2006. The policy appears to address the concerns raised by the bureau.

Finding #7: Student Aid needs to improve its oversight of EDFUND.

Student Aid has not provided sufficient oversight over EDFUND to ensure the future success of Student Aid's participation in the FFEL Program. Specifically, Student Aid circumvented state law by delegating its authority related to the approval of EDFUND's budget without amending the operating agreement. Student Aid also dismissed several policy and fiscal concerns raised by its staff responsible for analyzing these issues. Moreover, Student Aid does not always independently verify reports that it receives from EDFUND. Rather, it relies on EDFUND staff to ensure their accuracy. Finally, Student Aid has not completed several key tasks identified within its mandated performance review of EDFUND, despite its staffs' recommendations to actively pursue them. For example, neither Student Aid nor EDFUND has performed an adequate assessment of the financial risks associated with EDFUND's student loan guaranty portfolio, a critical piece of information that Student Aid should have considered before approving EDFUND's annual budgets and business plans.

We recommended that Student Aid rescind its delegation of the approval authority of EDFUND's detailed operating budget to the EDFUND board and follow through on issues raised by its staff regarding EDFUND's operations. Student Aid should also require staff to independently verify the accuracy of the reports submitted by EDFUND. Finally, it should complete key tasks outlined in the June 2005 mandated performance review of EDFUND.

Student Aid's Action: Partial corrective action taken.

On June 22, 2006, Student Aid rescinded its delegation of the approval authority of EDFUND's detailed operating budget to the EDFUND board.

In addition, according to Student Aid, except for three items, EDFUND has addressed the operational issues raised by Student Aid staff presented in its 2006–07 Loan Program Business Plan and Budget. The unresolved items relate to the multi-year default fee strategy for new loans guaranteed after July 1, 2007, and the Student Aid executive director's and EDFUND president's resolution of EDFUND's federal fiscal year 2006 performance goals involving the credit to be given for the turnover rate and recovery rate metrics.

Further, Student Aid informed the bureau that it hired a consultant in November 2006 to assist it in further delineating the roles and responsibilities between it and EDFUND and that this consultant will also be responsible for evaluating the activities of its oversight division including, but not limited to, the verification of reports submitted by EDFUND.

Finally, Student Aid has been unable to demonstrate that it addressed three of the six tasks cited in our report, which are to reexamine the basic assumptions of the current business model, reassess existing strategies, and undertake a thorough organizational risk assessment in relation to the existing portfolio and future growth strategies. Although it stated that these are activities EDFUND has historically addressed and continues to do so, Student Aid stated that it would provide the bureau with this information in April 2007.

Finding #8: The EDFUND board has violated state law governing closed-session meetings.

The EDFUND board has not fully complied with certain provisions in state law related to closed-session meetings. Specifically, on August 11, 2004, the governor approved Senate Bill 1108, which amended state law to give the board the authority to hold a closed-session meeting to consider a matter of a proprietary nature, the public discussion of which would disclose a trade secret or proprietary business information that could potentially cause economic harm to EDFUND or cause it to violate an agreement with a third party to maintain the information in confidence if that agreement were made in good faith and for reasonable business purposes.

Our review of documents kept by EDFUND for open meetings held between August 19, 2004, and December 13, 2005, found that in one instance the board clearly violated its closed-session authority. The documentation indicates that the board voted to retain outside counsel to advise it on this audit, which clearly does not qualify as business proprietary information or a trade secret.

Additionally, the board did not consistently keep a confidential minutes book of the topics discussed and decisions made in these sessions, as the Bagley-Keene Open Meeting Act of 2004 (Bagley-Keene Act) requires. Consequently, we were unable to determine the extent to which the board complied with its recent statutory authority for closed sessions and the closed-session meeting provisions of the Bagley-Keene Act. When we asked EDFUND's assistant general counsel about the board's current record-keeping practices, she stated that the board recently was made aware that a closed-session minutes book should be maintained. The assistant general counsel asserted that the board now uses a confidential minutes book that will be maintained by the board secretary or general counsel.

We recommended that Student Aid ensure that EDFUND complies with the Bagley-Keene Act record-keeping requirements by maintaining a confidential minutes book of the business discussed during its closed sessions. In addition, Student Aid and EDFUND should establish policies and procedures to help ensure that closed sessions are conducted within the board's authority as required by state law. These policies and procedures should provide the board and staff with clear guidelines in defining trade secrets and business proprietary information that can be discussed during closed sessions so that no further violations of state law occur.

Student Aid's Action: Partial corrective action taken.

Student Aid reported that EDFUND began keeping confidential minutes of its closed sessions as of the beginning of 2006. However, according to Student Aid, a policy/procedure for conducting closed sessions and maintaining the confidential minutes book has not been finalized.

DEPARTMENT OF FORESTRY AND FIRE PROTECTION

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATIONS I2005-0810, I2005-0874, I2005-0929
(REPORT I2006-1), MARCH 2006

Department of Forestry and Fire Protection's response as of
November 2006

Investigative Highlights . . .

- A Department of Forestry and Fire Protection (Forestry) supervisor approved improper overtime resulting in payments totaling more than \$58,000.***
 - A Forestry employee took advantage of a lack of oversight and improperly received \$3,445 for time he did not work.***
-

We investigated and substantiated an allegation that several Department of Forestry and Fire Protection (Forestry) employees improperly received overtime payments.

Finding #1: A Forestry supervisor authorized improper overtime for his employees.

The State's collective bargaining agreement with the firefighters' union provides for around-the-clock compensation when certain employees are assigned to a fire, but does not include air operations officers among those eligible for this type of compensation. Rather, air operations officers should be compensated only for actual hours worked instead of the duration of a fire incident. Further, department policy limits the number of work hours per day that its pilots are able to work to 14 hours. Because the air operations officers' reported overtime hours involved pilot coverage, these employees were subject to Forestry's 14-hour workday for pilots.

From January 2003 through July 2005, five air operations officers working as pilots received more than \$58,000 for 1,063 overtime hours charged in violation of either department policy or their union agreement. In addition, two air operations officers working in maintenance received nearly \$3,890 for overtime hours that it is not clear they actually worked. Specifically, we found that one air operations officer working in maintenance claimed five consecutive 24-hour workdays and the other maintenance officer claimed three consecutive 24-hour workdays, resulting in 80 total hours of overtime.

The supervisor of the air operations officers indicated that he mistakenly believed they were all entitled to around-the-clock pay when assigned to a fire.

Finding #2: A lax control environment allowed another Forestry employee to charge excessive and questionable overtime.

Between January 2004 and December 2005, Forestry paid a heavy fire equipment operator approximately \$87,000 for 3,919 overtime hours, of which we identified \$12,588 that is questionable and \$3,445 that is improper.

As opposed to the air operations officers we discussed previously, heavy fire equipment operators are entitled to around-the-clock compensation when they are assigned to a fire. The State's collective bargaining agreement with the firefighters' union provides that heavy fire equipment operators working this employee's schedule work a 12-hour day on the last day of their duty week. This employee improperly claimed 120 hours of overtime by reporting 24-hour shifts on the last day of his duty week, despite being counseled by his supervisor and being specifically told that he should report only 12 hours on the last day of his duty week. As a result, this employee improperly received \$2,769. In addition, this employee improperly claimed 27 hours related to training, receiving \$676 for hours he did not work. The aggregate amount of these improper payments totaled \$3,445.

Additionally, we question \$12,588 paid for 549 hours in which this employee reported hours for covering the shift of another employee who was also scheduled to work these same hours or reported hours for working the shift of another employee who was not scheduled to work.

Although this employee's direct supervisor acknowledged that he was not as diligent as he could have been when approving time sheets, he pointed out that when other battalion chiefs approve this employee's time sheets, he does not review those time sheets for accuracy.

Forestry's Action: Pending.

Forestry reported that it is taking steps to recover these overpayments. It also reported that it has taken steps to inform supervisors and managers of any significant changes to Bargaining Unit 8 agreements that would impact rank and file salary, benefits, or classification status.

DEPARTMENT OF CORRECTIONS AND REHABILITATION

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATION I2005-0781 (REPORT I2006-1),
NOVEMBER 2006

Department of Corrections and Rehabilitation's response as of
November 2006

Investigative Highlights . . .

***Department of Corrections
and Rehabilitation:***

- Allowed nine exempt employees to improperly accrue 516 hours of holiday credits, resulting in gifts of public funds of \$17,164.***
 - Allowed the same nine exempt employees to work alternate work schedules resulting in 1,460 hours of leave that did not have to be charged and gifts of public funds totaling \$49,094.***
-

We investigated and substantiated an allegation that the Department of Corrections and Rehabilitation (Corrections) failed to exercise its management controls, resulting in gifts of public funds at the Sierra Conservation Center (center).

Finding #1: Corrections improperly allowed center employees to accrue holiday credits when these employees were not required to work.

Contrary to the terms in the collective bargaining agreement, when a holiday fell on a scheduled day off, the center allowed exempt employees represented by the American Federation of State, County, and Municipal Employees (Union A) to accrue holiday credits for later use, even though they had not worked.

The current collective bargaining agreement between the State and Union A (Union A agreement), which is effective through July 1, 2006, specifically states that exempt employees accrue holiday credits when they are required to work on holidays.

The center improperly allowed nine exempt Union A employees to accrue 516 hours, resulting in gifts of public funds totaling \$17,164 between January 2002 and May 2005.



Corrections' Action: None.

Finding #2: Center employees do not charge leave credits to account for their full workday.

The collective bargaining agreement for Union A requires exempt employees to post leave only in eight-hour increments (or their fractional equivalent depending on their time bases) for each full day of work missed. At the same time, the center allowed nine exempt employees to work alternate work schedules consisting of 10-hour days.

The Union A agreement specifies that exempt employees can charge leave balances only in increments of eight hours, regardless of actual hours worked each day when leave credits are charged. It also requires the State to reasonably consider employees' requests to work alternate schedules. Alternate work schedules include, but are not limited to, working four 10-hour days in one week. The center allows both full- and part-time exempt employees represented by Union A to work alternate schedules. For example, a full-time employee can work four 10-hour days, a three-quarter-time employee can work three 10-hour days, and a half-time employee can work two 10-hour days to perform the requisite number of work hours in one week.

This presents a problem when these employees take a day off, because the center charges only eight hours against their leave balances for each day they are absent, although they are missing 10 hours of work per day. Overall, the center did not charge 1,460 hours to the leave balances of Union A employees who work alternate work schedules, resulting in a gift of public funds for \$49,094.



Corrections' Action: None.

VICTIM COMPENSATION AND GOVERNMENT CLAIMS BOARD AND DEPARTMENT OF CORRECTIONS AND REHABILITATION

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATIONS I2004-0983 AND I2005-1013
(REPORT I2006-1), MARCH 2006

Victim Compensation and Government Claims Board and Department of Corrections and Rehabilitation's responses as of November 2006

Investigative Highlight . . .

Victim Compensation and Government Claims Board and Department of Corrections and Rehabilitation made duplicate payments to an employee of nearly \$26,000.

We investigated and substantiated an allegation that the Victim Compensation and Government Claims Board (Board) improperly awarded payments to a physician at the California Department of Corrections and Rehabilitation (Corrections).

Finding: The Board and Corrections made duplicate payments on the physician's claims.

In January 2000 Corrections began paying a \$2,700 per month recruitment and retention bonus to Corrections' employees in the classification of chief psychiatrist (psychiatrist bonus). Between October 2000 and May 2002 a physician employed by Corrections filed multiple claims with both Corrections and the Board, stating that he was entitled to the psychiatrist bonus because he claimed he regularly devoted a portion of his work time to psychiatry. The physician received payments from both the Board and Corrections for essentially the same claim and ultimately received at least \$25,950 more than he was entitled to because of the duplicate payments. Further, although the Board and Corrections were aware that the physician was about to receive state funds to which he was not entitled before receiving his final payment and the physician himself directed the Board to reduce his claim on three separate occasions, neither entity adjusted the physician's final claim nor recovered the overpayment.

When the Board considered the physician's claims and made a determination regarding the amount to which he was entitled, the Board may have exceeded its legal authority, and violated its own policy. Moreover, when the Board paid the physician's claims, it relied on legal authority that allows it to order the payment of a claim "for

which no appropriation has been made.” It relied on this legal authority despite the fact that the department that had been ordered to pay this claim by the Department of Personnel Administration (DPA) did, in fact, have an appropriation of funds sufficient to satisfy this claim, and the Board was made aware of this fact before making the duplicate payments. Further, the Board reviewed this claim and determined the amount to which the physician was entitled in disregard of the advice of its own staff and notices from DPA that the Board lacked legal authority in this case.

It is well established that DPA is the state agency that has full authority related to the salaries and other entitlements, such as the retention bonus at issue here, of state employees. Further, Board staff recommended that it reject the claim for lack of authority to order Corrections to reclassify the physician’s position. However, Board members are not required to follow the recommendations of involved departments or its own staff and Board policy directs its staff to allow all claims against state agencies to be heard by the Board, regardless of whether the claim falls within the Board’s statutory authority.

Board’s Action: Partial corrective action taken.

The Board reported that it believes it had jurisdiction to hear the physician’s claims and again stated it did so under state law that allows the Board to hear claims when no statute or constitutional provision provides for a settlement. However, as previously mentioned, the fact that the physician also filed a grievance for essentially the same claim with Corrections and was awarded relief for that claim, clearly demonstrates that statutory relief was available in this case. Moreover, funds were readily available to pay this claim and the Board was informed of this fact prior to its payment of the physician’s claim.

The Board also reported that it has implemented changes that will prevent it from making overpayments in the future; however, these reported changes do not address the issue of the Board’s practice of allowing all claims against state agencies to be heard by the Board, regardless of whether there is other statutory relief available. Consequently, it appears that the Board still lacks the controls necessary to prevent it from hearing claims over which it lacks authority and possibly awarding additional duplicate payments in the future.

Corrections’ Action: Partial corrective action taken.

After we informed Corrections of the overpayment, it initiated action to attempt to recover the \$25,950 overpayment from the physician. As of the date of this report, Corrections reported it has recovered \$2,000 from the physician and is in the process of requiring him to reimburse the State approximately \$2,700 per month—the maximum amount allowed by law—until the total overpayment is collected.

➔ Corrections reported it could not pursue collecting the overpayment through payroll deductions because the overpayment was not a *payroll* overpayment. Corrections added that the physician is voluntarily making payments to the State; however, it was unable to tell us how much the physician is paying monthly or how much he has paid to this point.

DEPARTMENT OF FISH AND GAME

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATION I2004-1057 (REPORT I2006-1), MARCH 2006

Department of Fish and Game's response as of February 2006

Investigative Highlights . . .

The Department of Fish and Game:

- Provided gifts of free rent of more than \$87,000 to employees and volunteers.***
- Failed to report housing fringe benefits totaling almost \$3.5 million over a four-year period.***
- Deprived state and federal taxing authorities of as much as \$1.3 million in potential tax revenues for tax years 2002 through 2005.***

Other state departments:

- May have failed to report housing fringe benefits of as much as \$7.7 million.***
 - May have failed to capture as much as \$8.3 million in potential rental revenue.***
-

We investigated and substantiated the allegation, as well as other improper acts. The Department of Fish and Game (Fish and Game) allowed several state employees and volunteers to reside in state-owned homes without charging them rent. Consequently, Fish and Game violated the state law prohibiting state officials from providing gifts of public funds.

Finding #1: Fish and Game provided free housing to employees and volunteers and failed to report housing fringe benefits.

Fish and Game allowed several state employees and volunteers to reside in state-owned homes without charging them rent. Consequently, Fish and Game violated the state law prohibiting state officials from providing gifts of public funds. We identified seven volunteers and six employees who resided in state-owned homes in Fish and Game's North Coast Region but were not required to pay rent for a total of 718 months between January 1984 and December 2005. Because Fish and Game provided free rent to some employees and volunteers, the State did not receive more than \$87,000 in rental revenue to which it was entitled between January 1984 and December 2005.¹ Therefore, that amount represents a gift of state funds to the employees and volunteers residing in the state-owned homes and a loss in revenue to the State. State regulations provide that departments shall review the monthly rental and utility rates of state-owned housing every year and report those rates to the Department of Personnel Administration (DPA).

Based on a review of state-owned housing conducted by DPA, as well as on information provided by the departments to DPA, it appears that Fish and Game understated its employees' wages by more than \$867,000 each year from 2002 through 2005 because it did not report any fringe benefits for its employees who reside on state property at below-market rates. As a result, over the four-year period, state and federal tax authorities were unaware of the potential \$1.3 million in taxes associated with a total of nearly \$3.5 million in potential housing fringe benefits.

¹ This conservative amount is based on the nominal rents Fish and Game charges when it requires its employees to pay rent. However, if fair market value, as determined by the Department of Personnel Administration, were applied to the 718 months of free rent, this figure could be greater.

Fish and Game's Action: None.

Fish and Game reported that it disagrees with the amount we show as being reportable housing fringe benefits and the associated potential tax revenues. Specifically, Fish and Game believes our report overstates the alleged taxable fringe benefits and associated potential tax revenues because it has determined that a majority of its resident employees meet the condition-of-employment test, and that the fair market values used in the DPA review do not accurately reflect the values of its properties.²

Based on our review of applicable tax law and the records we reviewed at Fish and Game's North Coast Region, we determined Fish and Game did not properly document and demonstrate that a majority of its employees met the condition-of-employment test. Further, although we acknowledge that the fair market values used in DPA's review may not reflect the actual value of all department holdings, DPA was unable to use actual fair market values because Fish and Game failed to determine and report to DPA the fair market value rates for any of its properties—rates it also needed to fulfill its responsibility to accurately report the housing fringe benefits realized by its employees. Fish and Game also reported that current budget constraints prohibit it from obtaining appraisals to determine the most accurate fair market values, but that it is considering requesting funding to do so. However, Fish and Game charges its employees rent at less than 25 percent of the fair market rates used by DPA. If current appraisals were to value the properties at half the values used by DPA, and if it were to raise rental rates to those fair market values, it appears that Fish and Game could recover the cost of such appraisals within one or two months.

In addition, Fish and Game reported that it disagrees with our conclusion that certain personnel received gifts of state funds because our report incorrectly presumes that Fish and Game is obligated to charge fair market rates for all of its housing and it is Fish and Game's understanding that rental rates are fixed and limited by state law, regulations, and employee collective bargaining agreements.

Our conclusion in the report that Fish and Game provided gifts of state funds of over \$87,000 to specific personnel is not based on a comparison to fair market values as Fish and Game asserts. Rather, the amount we report is based on a comparison of free rent, versus the nominal rate Fish and Game charges when it requires its employees to pay rent, which appears to be well below fair market value. Additionally, we disagree with Fish and Game's assertion that rental rates are fixed by state law, regulations, and employee collective bargaining agreements. DPA is the agency responsible for administering state housing regulations, and state law provides that the director of DPA shall determine the fair and reasonable value of state housing. Using information reported by Fish and Game for DPA's 2003 survey, DPA directed Fish and Game to raise rental rates to fair market value and acknowledged that it should do so in accordance with employee collective bargaining agreements, which allow Fish and Game to raise rental rates by 25 percent annually. Additionally, our review of records in the North Coast Region found that Fish and Game has in fact adjusted the amount of rent it charges residents on numerous occasions in the past, thus demonstrating that the rates it charges its residents are not "fixed."

Finally, Fish and Game reported that it has been working with DPA for several years as part of its commitment to ensure that it is in compliance with laws and regulations applicable to its properties and is committed to continuing to do so. Fish and Game added that part of this commitment included providing updated information regarding housing-related reporting and withholding requirements to its employees and administrative personnel in July 2002 and again in August 2003. However, as we previously mentioned, Fish and Game has not reported a state-housing fringe benefit for any of its employees since 2001 and it appears it is not in compliance with IRS regulations governing reportable housing fringe benefits despite Fish and Game's assertion that it is committed to doing so.

² The difference between the fair market value and the rental amount paid by the resident represents a taxable fringe benefit to the resident unless residing on state property is a condition of employment. To meet the conditions of employment test, Internal Revenue Service guidelines provide that the employee's residence must be the same place in which he or she conducts a significant portion of his or her workday. The guidelines add that the employee must be required to accept on-site lodgings to perform their duties because the housing is indispensable to the proper discharge of their assigned duties.

Finding #2: Other state departments have also failed to report housing fringe benefits.

Although we focus on Fish and Game’s management of state-owned housing in this report, the housing review conducted by DPA shows that all 13 state departments that own employee housing may be underreporting or failing to report housing fringe benefits. For example, the Table shows that in 2003 state departments may have failed to report housing fringe benefits totaling as much as \$7.7 million, depriving state and federal tax authorities of as much as \$3 million annually in potential tax revenues. Additionally, because state departments have chosen to charge employees rent that is well below market rates, the State may have lost as much as \$8.3 million in potential rental revenue in that year.³

TABLE

**Potential Income and Benefits Related to Rental Housing
Units Held by State Departments, 2003**

Department	Rental Units	Annual Income If Rented at Fair Market Value (FMV)	Annual Rent Charged	Lost State Revenue (Difference Between FMV and Rent Charged)*	Taxable Fringe Benefit Reported	Unreported Taxable Fringe Benefits†
Department of Parks and Recreation	487	\$ 4,778,496	\$ 763,488	\$4,015,008	\$373,198	\$3,641,810
Department of Corrections and Rehabilitation	176	2,139,972	909,732	1,230,240	0	1,230,240
Department of Developmental Services	99	1,254,360	309,240	945,120	5,728	939,392
Department of Fish and Game	168	1,124,532	257,316	867,216	0	867,216
Department of Forestry and Fire Protection	72	559,332	218,400	340,932	53,078	287,854
Department of Mental Health	40	366,720	125,472	241,248	34,031	207,217
Division of Juvenile Justice	51	371,760	136,740	235,020	69,152	165,868
Department of Transportation	42	294,984	144,324	150,660	17,300	133,360
Department of Veterans Affairs	22	235,224	97,512	137,712	9,240	128,472
Santa Monica Mountains Conservancy‡	9	82,512	0	82,512	0	82,512
California Highway Patrol	6	41,184	12,732	28,452	0	28,452
Department of Food and Agriculture	5	29,18	5,844	23,340	0	23,340
California Conservation Corps	4	36,888	20,748	16,140	3,058	13,082
Totals	1,181	\$11,315,148	\$3,001,548	\$8,313,600	\$564,785	\$7,748,815

Source: 2003 Department of Personnel Administration Departmental Housing Survey.

* This amount represents what should have been reported to taxing authorities as a taxable fringe benefit.

† Taxable housing fringe benefits exist when the rental rate charged is less than the fair market rate. Thus, no taxable fringe benefit exists when employees pay fair market rates.

‡ No rent was charged for any department properties.

³ Taxable fringe benefits exist when the rental rate charged is less than the fair market rate. Thus, no fringe benefit exists when employees pay fair market rates.

Department of Parks and Recreation's Action: None.

The Department of Parks and Recreation (Parks and Recreation) believes that the state regulations relevant to state-owned housing for employees not represented by collective bargaining agreements (non-represented employees) do not allow it to raise rental rates beyond those listed in the regulations and stated that non-represented employees reside in approximately one-third of its properties. However, after reviewing the information Parks and Recreation submitted to DPA, it appears that non-represented employees reside in less than one-tenth of its inhabited properties. Regardless, Parks and Recreation believes that in order for it to raise rental rates for its non-represented employees and not violate state regulations, DPA must update the rates listed in state regulations. Parks and Recreation added that many of the collective bargaining agreements, under which most of its remaining employee residents work, limit its ability to raise rental rates. However, DPA, the agency responsible for administering state housing regulations, has specifically given Parks and Recreation direction to raise rental rates to fair market value and acknowledges that it should do so in accordance with employee collective bargaining agreements. These agreements generally allow Parks and Recreation to raise rental rates by 25 percent annually up to fair market value. After receiving this direction, Parks and Recreation responded to DPA, requesting that DPA provide clear authority and policy direction to departments, and inform employee unions of this direction; however, DPA has not responded to this request.

Parks and Recreation also reported that it believes the fair market values used in DPA's review do not fairly represent the true value of its homes. We acknowledge that the fair market values used in DPA's review may not reflect the actual value of all department holdings; however, DPA was unable to use the actual fair market values because Parks and Recreation failed to determine and report to DPA accurate fair market value rates for all of its properties—rates it also needed to fulfill its responsibility to accurately report the housing fringe benefits realized by its employees. After reviewing the information it submitted to DPA, it appears that it provided fair market determinations for only 298 of the 817 properties it owns. Moreover, Parks and Recreation failed to indicate when the last appraisal was conducted for all but 90 of the 298 properties and had conducted appraisals on only 14 of those properties in the previous 10 years, thus demonstrating that it did not report accurate, up-to-date fair market rates to DPA.

Parks and Recreation also takes issue with the amounts identified by DPA as losses in state revenue and underreported fringe benefits because many of its employees live on state property as a condition of employment and therefore, there is no loss in rental revenue to the State or fringe benefit to report. However, after reviewing the information provided to DPA, it appears that Parks and Recreation did not clearly indicate which, if any, of its residents resided on state property as a condition of employment. Specifically, even though the survey guidelines instructed Parks and Recreation to indicate the reason for occupancy for each of its properties, it did not list as a reason condition of employment for any of its properties.

Department of Corrections and Rehabilitation's Action: Pending.

The Department of Corrections and Rehabilitation (Corrections) reported that it last established fair market value rates for all its properties in 1999 and that it subsequently raised rents to the 1999 fair market value rates for properties at all but one of its institutions. Corrections added that it has since raised rates at the remaining institution and is committed to hiring a consultant within six months to begin obtaining current fair market value appraisals.

Corrections reported that it attempted to obtain the services of a consultant to perform fair market appraisals for its properties through the state procurement process; however, Corrections decided not to contract with the lone responsive bidder because it believes that the consultant's fees were too high. Corrections added that it plans to use housing appraisal services through a master services agreement initiated by DPA that is projected to be in place in April 2007.

Department of Developmental Services' Action: Pending.

The Department of Developmental Services (Developmental Services) reported that it believes the fair market rates used by DPA do not accurately reflect the true value of its properties because many of its units are single rooms without kitchens and in some cases residents share bathrooms. We acknowledge that the fair market rates used in the DPA review may not reflect the actual value of all department holdings; however, DPA was unable to use the actual fair market rates because Developmental Services failed to determine and report to DPA the fair market value rates for any of its properties—rates it also needed to fulfill its responsibility to accurately report the housing fringe benefits realized by its employees.

Developmental Services also reported that it has initiated steps to obtain fair market appraisals for all its properties and will follow provisions in applicable collective bargaining agreements to increase rental rates commensurate with the fair market appraisals once they are established.

Department of Forestry and Fire Protection's Action: Partial corrective action taken.

The Department of Forestry and Fire Protection (Forestry) reported that it has taken several steps to resolve state housing issues since it reported information to DPA for its review in 2003. Specifically, Forestry reported that it now reviews rental rates each year and rents that are below fair market value will be raised by 25 percent annually in accordance with applicable collective bargaining agreements. It also reported that it currently reports taxable fringe benefits for residents in Forestry housing on a monthly basis. In addition, Forestry reported that the fair market rates used by DPA do not accurately reflect the true values of its properties because most are located within the boundaries of conservation camps primarily occupied by prison inmates; however, it acknowledged that annual appraisals are necessary to document the accurate value of each unit. Finally, due to increased rental rates and additional vacancies, Forestry reported that the difference between fair market value and actual rental income for all of its properties in 2005 was \$32,805 and that by increasing rents 25 percent each year, the difference will continue to decline.

Department of Mental Health's Action: Partial corrective action taken.

The Department of Mental Health (Mental Health) reported that it believes the fair market rates used in DPA's review do not accurately represent the values of its properties but acknowledged that many, if not all, of its state hospitals have been using outdated fair market values. Mental Health also reported that it will update its special order concerning employee housing to include performing annual fair market value determinations and promptly reporting housing fringe benefits. The special order will be distributed to each of its four state hospitals and Mental Health will monitor the hospitals for ongoing compliance. Mental Health added that for certain purposes, such as the recruitment and retention of interns, its state hospitals charge less than fair market value and in these instances Mental Health will ensure that the hospitals report the housing fringe benefits in accordance with state and federal regulations.

Division of Juvenile Justice's Action: None.



The Division of Juvenile Justice reported that it last obtained fair market value appraisals for all of its properties in 1995 and that it subsequently raised rental rates to the 1995 fair market value rates.

Department of Transportation's Action: Corrective action taken.

The Department of Transportation (Caltrans) reported that it believes the fair market rates used by DPA do not accurately reflect the true value of its properties because all of its properties are located in remote areas situated within Caltrans maintenance facilities. Caltrans also reported that its policies require that it charge fair market value for all employee housing and that it update fair market values annually; however, Caltrans was unable to explain why it did not report fair market values to DPA. Although we did not validate its analysis, Caltrans reported that based on its most recent fair market value determinations, the loss of state revenue in 2003 was only \$19,356 and the amount of underreported fringe benefits was much less than what DPA identified in its review.

Department of Veterans Affairs' Action: Corrective action taken.

The Department of Veterans Affairs (Veterans Affairs) reported that it conducted fair market assessments of its properties in September 2005 and that it submitted its corrected housing information to DPA in October 2005. Veterans Affairs also reported that it established new rental rates based on the assessments and informed its residents that the new rates would take effect March 1, 2006.

Santa Monica Mountains Conservancy's Action: Corrective action taken.

The Santa Monica Mountains Conservancy reported that it has only six employees, none of whom live on state property. It added that in lieu of rent, it currently allows non-state employees to reside on eight of its properties to provide and ensure resource protection, site management, facilities security and maintenance, and park visitor services.

California Highway Patrol's Action: Partial corrective action taken.

The California Highway Patrol (Highway Patrol) reported that it determines rental rates in accordance with applicable state regulations and that because all of its employees reside on state property as a condition of employment, it has not underreported housing fringe benefits. The Highway Patrol added that it is in the process of obtaining appraisal reviews for its properties and is updating its policies and procedures to reflect that assignments to its resident posts are classified as "condition of employment."

Department of Food and Agriculture's Action: Corrective action taken.

The Department of Food and Agriculture (Food and Agriculture) reported that its employees currently reside on two state properties as a condition of employment. As a result, there is no fringe benefit to report for those residents. Food and Agriculture added that because these properties are located near popular resort areas, fair market values are not comparable to values of homes in surrounding communities.

California Conservation Corps' Action: Pending.

The California Conservation Corps (Conservation) reported that it will be conducting new appraisals to determine updated fair market values for its properties and that rental rates will be increased to the extent allowed by law and applicable collective bargaining units. Conservation also stated it would report on the fringe benefit amount—the difference between the rent charged and the fair market value determined by these new appraisals—for employees residing on its properties, and has informed affected employees of this fact.

CALIFORNIA K-12 HIGH-SPEED NETWORK

The Network Architecture Is Sound, but Opportunities Exist to Increase Its Use

REPORT NUMBER 2005-116, JANUARY 2006

The Department of Education's response as of January 2007

Audit Highlights . . .

Our review of the California K-12 High-Speed Network (High-Speed Network) found that:

- The State most likely spent less on the building and operation of the High-Speed Network by expanding the existing infrastructure used by the University of California and other higher education institutions than it would have spent for a separate network with comparable services.*
- A study conducted by our technical consultant in 2005 found that the High-Speed Network has adequate bandwidth for potential growth but is not overbuilt. Furthermore, our technical consultant found no compelling technical or financial reason to abandon the existing High-Speed Network.*
- Because of the lack of specific performance measures in state law and because the Imperial County Office of Education (ICOE), which currently administers the project, is in the early stages of developing a suitable plan for measuring the success of the High-Speed Network, it is difficult to determine whether the network accomplishes the Legislature's goals.*

continued on next page . . .

The California K-12 High-Speed Network (High-Speed Network) connects the vast majority of kindergarten through 12th grade (K-12) schools, school districts, and county offices of education statewide to each other, to California's universities and community colleges, and to various Internet service providers that provide access to the commodity Internet. The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to determine whether the State is efficiently using its resources by supporting the maintenance of the High-Speed Network. Specifically, the audit committee asked the bureau to determine the roles and responsibilities of the various entities involved since the inception of the High-Speed Network project, to identify the network's funding sources and determine whether there are any limitations or restrictions on the use of this funding or on the disposition of unused funds, and to review the methods used to allocate the costs of the High-Speed Network to determine if they are reasonable. In addition, the audit committee instructed the bureau to review the cost, usage, and, to the extent possible, benefits of the High-Speed Network and to determine whether these costs and benefits are comparable to those of other Internet service providers. The audit committee also directed the bureau to examine any information the State, consortium, or other entity has used to determine whether the benefits of the network outweigh its costs. Further, the bureau was asked to evaluate the reasonableness of any options or plans the State or consortium of county offices of education considered to maximize the use of the High-Speed Network. Moreover, the audit committee requested that the bureau determine the ownership rights to purchases made or services related to the High-Speed Network, including but not limited to intellectual property rights and how the State may exercise those rights. Finally, the bureau was asked to review and evaluate the laws, rules, and regulations significant to the objectives stated above.

Finding #1: From the beginning, state law has provided limited guidance and oversight for the High-Speed Network project.

Between fiscal years 2000–01 and 2003–04, the budget control language that appropriated more than \$93 million to the University of California (UC) for the High-Speed Network stated only that the purpose of the funding was for “expanding the Internet connectivity and network infrastructure

☑ *As of June 30, 2005, the Corporation for Education Network Initiatives in California (CENIC), the nonprofit that built and currently operates the network, held \$13.6 million in High-Speed Network funds and it expects to receive an additional \$3.6 million related to telecommunication discounts in fiscal year 2005–06. These funds are being used to keep the network operating in fiscal year 2005–06 or are held for future equipment replacement.*

☑ *Opportunities exist for ICOE to strengthen its agreements with CENIC to better protect the State’s interests. Specifically, its agreements lack detailed service-level agreements, do not ensure that it retains ownership of tangible nonshared assets, and do not ensure that interest earned on advance payments made to CENIC or funds held by CENIC on its behalf accrue to the benefit of the High-Speed Network.*

for K-12.” This budget control language did not impose any more specific requirements or controls on the expenditure of these funds, nor did the Legislature enact legislation to further define the parameters of this project or what was meant by “Internet connectivity and network infrastructure for K-12.” Therefore, it is difficult to determine if the Legislature got what it sought in appropriating the funds.

In the Budget Act of 2004, the Legislature effectively transferred the responsibility for managing the Internet connectivity and infrastructure for K-12 educational institutions from UC to the California Department of Education (Education). Although the Legislature shifted control of this project from UC to Education and ultimately to the Imperial County Office of Education (ICOE), it still has not enacted legislation that clearly prescribes the goals to be accomplished using these funds. Until legislation is enacted, Education cannot be certain that the design and use of the High-Speed Network are achieving the Legislature’s desired outcomes.

We recommended that to ensure that the High-Speed Network meets its expectations, the Legislature should consider enacting legislation that prescribes the specific goals and outcomes it wants from the High-Speed Network project.

Legislative Action: Legislation enacted.

Legislation (Assembly Bill 1228) was enacted on September 28, 2006, that requires the Superintendent of Public Instruction (Superintendent) to, among other things, establish a High-Speed Network advisory board. The legislation requires the advisory board to meet quarterly and to recommend policy direction and broad operational guidance to the Superintendent and the Lead Education Agency responsible for administering the High-Speed Network on behalf of the Superintendent. The advisory board, in consultation with the Lead Education Agency, shall develop recommendations for measuring the success of the network, improving network oversight and monitoring, strengthening accountability, and optimizing the use of the High-Speed Network and its ability to improve education. The advisory board shall report its recommendations to the Legislature, the governor, the Department of Finance, the Legislative Analyst’s Office, and the Office of the Secretary for Education by March 1, 2007. It is the Legislature’s intent that the report identifies and recommends specific annual performance measures that should be established to assess the effectiveness of the network.

Finding #2: The current agreement between ICOE and the Corporation for Education Network Initiatives in California (CENIC) could be strengthened to better protect the State's interests.

UC contracted with CENIC to carry out the High-Speed Network project. After its selection as the lead agency in 2004, ICOE entered into agreements with CENIC under terms that were substantially similar to UC's agreement. The first was executed December 1, 2004, and the second was executed June 24, 2005, and became effective July 1, 2005, after the first agreement expired. Both agreements continue to lack service-level agreements. A service-level agreement describes the specific level of service a vendor is required to provide and typically provides a penalty if that level is not provided. The lack of a service-level agreement makes it difficult to monitor CENIC's performance. Additionally, the agreements fail to contain provisions that fully address the issue of the State's ownership of assets and that require CENIC to limit the use of interest earned on advance payments it receives related to the High-Speed Network.

We recommended that to ensure that the High-Speed Network is appropriately managed, Education should ensure that ICOE does the following:

- Develops a comprehensive and extensive set of service-level agreements based upon applications to be delivered via the High-Speed Network project.
- Requests that CENIC provide a master service-level agreement for its review.
- Includes the appropriate service-level agreements in its ongoing contracts with CENIC and other service providers for the High-Speed Network, using industry standards.

To ensure adequate protection of the State's interest in tangible, nonshared assets, we also recommended that Education should direct ICOE to transfer ownership of those types of assets to the State, to the extent that ICOE is able to bargain for the provision.

Finally, we recommended that to ensure that the interest earned on advance payments made to CENIC are used to benefit the High-Speed Network, Education should direct ICOE to amend its agreement with CENIC to stipulate the allowable use of the interest earned.

Education's Action: Corrective action taken.

Legislation (Assembly Bill 1228) was enacted on September 28, 2006, that requires the Lead Education Agency to enter into appropriate contracts for the provision of high-speed, high-bandwidth Internet connectivity, provided such contracts secure the necessary terms and conditions to adequately protect the interests of the State. The terms and conditions are to include, but are not limited to, all of the following:

- (a) Development of comprehensive service level agreements.
- (b) Protection of any ownership rights of intellectual property of the State that result due to its participation in the High-Speed Network.
- (c) Appropriate protection of state assets acquired due to its participation in the High-Speed Network.
- (d) Assurance that appropriate fee structures are in place.
- (e) Assurance that any interest earned on funds of the State for this purpose are used solely to the benefit of the project.

Education stated that ICOE has not entered into any agreements with service providers, and that, if and when it does, those agreements will include the appropriate service-level agreement terms. Education also stated that ICOE and CENIC have reached agreement on both a master-service level agreement and a service-level agreement for the services CENIC delivers to the High-Speed Network. Our review of the first amendment to the master agreement executed by ICOE and CENIC on January 30, 2007, found that the amendment does contain these provisions. Additionally, the amendment contains language that will require CENIC to transfer ownership of tangible non-shared assets to the State if CENIC ceases to serve K-12 entities. Finally, Education reported that fiscal year 2006–07 budget control language requires “any interest earned on state monies is used for operating the CalREN serving the UC, CSU, CCC, and K-12 segments. Any segment-specific cash reserves held by CENIC for an individual segment shall be held separately and accrue interest to that segment.” The amended agreement between ICOE and CENIC stipulates that interest earned be used in accordance with this budget control language.

Finding #3: CENIC’s charges for commodity Internet use could have been lower.

CENIC provides connections to Internet service providers, enabling High-Speed Network users to access the commodity Internet. Although the annual fees it charges for this access are lower than state negotiated pricing, it could further reduce the amount it charges users by consistently using funds left over from prior-year fees to offset the next year’s cost of providing the service.

CENIC’s commodity Internet service, which became effective during fiscal year 2002–03, has generated a surplus each year; as of June 30, 2005, this surplus was \$2.1 million. The commodity Internet service model approved by its board in June 2001 specifically states that the fixed rate charged per unit of commodity Internet usage should be set to enable CENIC to recover the entire cost of providing the services, should be reviewed semiannually, and should be adjusted downward if cost recovery is projected to be excessive. CENIC did use a portion of its fiscal year 2002–03 surplus revenues to reduce its per-unit rate in fiscal year 2003–04 by 38 percent. For fiscal year 2004–05, however, although CENIC reduced its per-unit rate by a further 25 percent compared to its fiscal year 2003–04 per-unit rate, it did not use the surplus revenues to do so. It achieved its reduction by reducing its estimated annual costs and increasing the minimum usage commitments for commodity Internet service for certain users. We believe that further reductions would have been possible if CENIC had also used a portion of the surplus.

We recommended that to ensure that CENIC’s per-unit rate for access to the commodity Internet is closer to its actual cost to provide the service, Education should require ICOE to amend its agreement with CENIC to stipulate that to the extent possible, CENIC should use its surplus Internet service program revenues from each year to offset the per-unit rate that it sets the following year. ICOE should also stipulate in its agreement that if CENIC is unable to apply the surplus revenue due to a change in its financial position, that CENIC should provide ICOE with documentation to support its inability to do so.

Education’s Action: Corrective action taken.

Education reported that ICOE is currently a participating member of CENIC’s Business Advisory Council and board. Additionally, K-12 representatives are participating members of CENIC’s audit and finance committees. Education believes that this participation on behalf of K-12 provides equal input (compared with other public segments participating in CENIC) into CENIC’s decisions regarding rates and the use of surplus revenues. Finally, the first amendment to the master

agreement executed by ICOE and CENIC indicates that for fiscal year 2006–07 CENIC now recovers the fixed portion of commodity Internet costs using a flat rate contribution by the participating entities. Consequently, CENIC was able to reduce its per-unit rate for the entities' actual usage of the commodity Internet from \$95 to \$29, a reduction of almost 70 percent.

Finding #4: CENIC has a portion of the High-Speed Network's funds in its consolidated equipment replacement account.

During its September 12, 2002 meeting, CENIC's board approved the following three action items related to the High-Speed Network funds held by CENIC for equipment replacement: (1) the creation of a consolidated designated equipment replacement account as part of its CalREN account, the transfer of \$5.7 million in High-Speed Network funds from an account designated solely for the High-Speed Network into this new account, and the transfer of future High-Speed Network equipment replacement funds into this new account; (2) the transfer of \$970,000 of the interest income in an account designated solely for the High-Speed Network into the consolidated designated equipment replacement account; and (3) the transfer of \$6 million from the consolidated designated equipment replacement account into a one-year certificate of deposit with a bank, the borrowing of \$6 million from the same bank, and the use of the certificate of deposit as collateral against the loan. According to CENIC's accounting records, on June 30, 2004, an additional \$1.5 million was placed into the consolidated designated equipment replacement reserve account using state appropriations for the High-Speed Network.

The board's decision to include the High-Speed Network's equipment replacement funds into a consolidated account appears inconsistent with CENIC's agreement with UC, which requires CENIC to set up and use a separate financial account for the High-Speed Network funds and to not use that account to hold or disperse any other funds. The purpose of establishing a separate financial account for the High-Speed Network funds is to ensure that these funds are being used to benefit the project. The transfer of these funds to CENIC's consolidated account makes it difficult to identify those funds belonging to the High-Speed Network.

Further, CENIC could not provide us with a technology refresh plan. An effective technology refresh plan establishes the points along the service life of a product or system at which it is optimal to change system components. Without a technology refresh plan, we do not believe CENIC can support its assertion that it needs the full \$7.2 million, or that only \$4.9 million represents funds for the replacement of equipment specific to the High-Speed Network.

Finally, although CENIC is holding \$7.2 million in High-Speed Network funds for equipment replacement, any interest earned on this money does not accrue to the benefit of the High-Speed Network. Specifically, its agreement with ICOE does not contain a provision that limits the use of any interest earned on state appropriations to the High-Speed Network. By including this provision in its agreement, ICOE can ensure that the project benefits directly from any interest earnings.

To ensure that High-Speed Network equipment replacement funds are used to benefit the K-12 education community, we recommended that Education should direct ICOE to request that CENIC reestablish a reserve for equipment replacement that is in an account solely for the High-Speed Network. Further, CENIC should consult with ICOE on the development of a technology refresh plan, which ICOE should use to establish its own equipment replacement funds for the High-Speed Network. Finally, ICOE should amend its agreement with CENIC to stipulate that interest earned on the funds held in the High-Speed Network's equipment replacement account accrues to the benefit of the High-Speed Network.

Education's Action: Corrective action taken.

Our review of ICOE's amended master agreement with CENIC found that it requires K-12 equipment replacement funds to be segregated into a separate account. Additionally, ICOE and CENIC developed a 2006–2009 technology refresh plan in January 2007 to address the appropriate use of the funds for the replacement of equipment specific to the High-Speed Network. Education stated that upon the advisory board's approval, and contingent upon available funding, the implementation of the plan will occur over two years and modifications will be made as necessary in response to industry changes. Finally, Education reported that the fiscal year 2006–07 budget control language requires that "any interest earned on state monies is used for operating the CalREN serving the UC, CSU, CCC, and K-12 segments. Any segment-specific cash reserves held by CENIC for an individual segment shall be held separately and accrue interest to that segment." The amended agreement between ICOE and CENIC stipulates the use of interest earned, including interest earned on funds held in an equipment replacement account, in accordance with this budget control language.

Finding #5: ICOE's agreement does not require CENIC to increase the amount that it holds on behalf of ICOE by any interest earned on funds related to E-rate or California Teleconnect Fund discounts.

In accordance with their contract executed on December 6, 2004, ICOE and CENIC plan to use unspent E-rate and California Teleconnect Fund discounts to continue the operation of the High-Speed Network in fiscal year 2005–06. The contract states, "To the extent that program revenue balances generated by E-rate and California Teleconnect fund discounts from fiscal year 2002–03, or prior fiscal years exist, such balances will be held by CENIC to help meet cash flow needs." The contract further stipulates, "Such funds will be held in trust by CENIC for the benefit of the High-Speed Network and will not be expended without advance consultation with ICOE." Finally, ICOE and CENIC agreed that any E-rate and California Teleconnect Fund discounts for fiscal year 2004–05 circuit expenditures received in that year shall be held by CENIC and applied against the network circuits, backbone fees, and related costs in fiscal year 2005–06.

E-rate—or, more precisely, the Schools and Libraries Universal Service Support Mechanism—is a federal program that provides discounts to assist most schools and libraries in the United States to obtain affordable telecommunications and Internet access. Eligible schools can receive discounts ranging from 20 percent to 90 percent. All customers eligible to receive E-rate discounts for telecommunication services can also receive discounts from the California Public Utilities Commission, via the California Teleconnect Fund program. The discounts are 50 percent and must be applied after deducting the E-rate discount.

As of December 2005, according to CENIC's estimate, a total of \$10 million was available for use toward the fiscal year 2005–06 High-Speed Network operational costs. However, ICOE's agreement does not require CENIC to increase the amount that it holds on behalf of ICOE by any interest earned on the funds. Until ICOE modifies its agreement with CENIC, the State will continue to lose the ability to use interest earnings to reduce High-Speed Network costs.

We recommended that to ensure that any interest earnings received for E-rate and California Teleconnect Fund discounts accrue to the benefit of the High-Speed Network, Education should direct ICOE to amend its agreement and require CENIC to credit any interest earnings to the High-Speed Network project. Additionally, ICOE should require CENIC to provide a detailed accounting of E-rate and California Teleconnect Fund discounts so that it can verify that it received the appropriate amount of interest.

Education's Action: Corrective action taken.

Education reported that the fiscal year 2006–07 budget control language requires that “any interest earned on state monies be used for operating the CalREN serving the UC, CSU, CCC, and K-12 segments. Any segment-specific cash reserves held by CENIC for an individual segment shall be held separately and accrue interest to that segment.” The amended agreement between ICOE and CENIC stipulates the use of interest earned, including interest earned on E-rate and California Teleconnect Fund discounts, in accordance with this budget control language.

The amended master agreement requires CENIC to keep detailed records and to work closely with ICOE to monitor and track revenues and interest related to E-rate and California Teleconnect Fund discounts. Further, Education stated that if CENIC holds E-rate and California Teleconnect Fund discounts on behalf of K-12 in the future, periodic audits will be conducted to ensure the appropriate amounts of revenue are received and that, if such funds are retained by CENIC instead of paid over immediately to ICOE, appropriate interest is credited to K-12.

Finding #6: Although ICOE has worked to increase awareness of content it postponed awarding grant funds to develop content hosted on the High-Speed Network.

As lead education agency for the High-Speed Network, ICOE is responsible for technical oversight of the project, financial and administrative services, collaboration and coordination with other agencies and projects, and the advancement of network uses.

ICOE currently provides certain videoconferencing services at no cost to schools in California that are connected to the High-Speed Network. Videoconferencing is a tool that connects two or more locations with interactive voice and video. Additionally, in November 2004, ICOE began operating its own High-Speed Network Web site that includes links and information related to learning resources, such as the UC College Preparatory Initiative, and the California Digital Library. Moreover, ICOE's application coordination committee (application committee) is evaluating some methods related to linking with academic content, from various sources, that are aligned with the California content standards for placement on the High-Speed Network. For example, ICOE plans to identify and work with academic content providers to develop strategies for placing their content on the network.

ICOE created the Advancing Network Uses Grant program to support the development and sharing of applications and learning resources that meet the critical needs of California's schools and that make good use of the benefits of the High-Speed Network. However, ICOE did not award the grant funds of roughly \$650,000 in fiscal year 2005–06 as planned because it was uncertain as to whether the High-Speed Network would receive state funding in fiscal year 2005–06. According to ICOE, should state funds be appropriated in the future, and provided enough funding exists, it will award funds to the winners of that previous grant competition.

Finally, both CENIC and ICOE have made an effort to increase the usage of the High-Speed Network by assisting schools and school districts in connecting their LANs to existing node sites, which is commonly referred to as the last mile connection. However, in June 2005, given the uncertainty of the fiscal year 2005–06 budget, ICOE decided to table the awarding of \$1.1 million in last mile grants. ICOE estimated that it would cost roughly \$10 million to connect the remaining roughly 500 schools and school districts without any connection. It further stated that when funds become available, it would determine how best to proceed with the last mile grant program.

We recommended that to maximize the benefits of the High-Speed Network, Education should ensure that ICOE does the following:

- Continue its efforts to implement statewide videoconferencing.
- Continue the efforts of its application committee to identify academic content and application uses to place on the High-Speed Network.
- Continue with its plans to fund the Advancing Network Uses Grant applicants.
- Proceed with its last mile grant program.

Education's Action: Partial corrective action taken.

Education stated that ICOE has implemented a fully functional statewide videoconferencing system. Education also stated that the application committee continues to assist the High-Speed Network project staff in identifying applications and Web-based resources to support teaching and learning.

Finally, Education stated that the Budget Act of 2006 did not include funding for the Advancing Network Uses Grant and last mile grant program, but it will continue to work with resource providers and to seek ways to cost-effectively connect schools and districts across the State. During fiscal year 2006–07, the High-Speed Network project staff collected up-to-date information on the state of connectivity in California. If resources are available, the project staff will be able to prioritize location for the last mile grant program.

Finding #7: ICOE is in the early stages of developing a suitable plan for evaluating the success of the High-Speed Network.

Although Education requires administrators of certain education technology projects to work with ICOE on the High-Speed Network project, ICOE is in the early stages of developing a method to evaluate the statewide success of the High-Speed Network. According to ICOE, it is working closely with Education to obtain existing data from certain education technology projects and is evaluating these data to determine if they will assist it in tracking the types of applications the K-12 education community is using. Establishing a method to track K-12 network use is key to measuring the success of the High-Speed Network project.

Until ICOE establishes a process to measure the success of the High-Speed Network that includes tracking the type of applications the K-12 education community is using, and the Legislature establishes clear goals for the program, it is difficult to determine whether the network has achieved such goals.

We recommended that Education should ensure that ICOE develops a process to measure the success of the High-Speed Network.

Education's Action: Partial corrective action taken.

Education stated that it and ICOE are collaborating with various stakeholders to assess the impact technology has on education. Specifically, they are coordinating the use of information collected from certain education technology projects and will continue to work toward developing analyses

and reports as well as modifying data collection tools as appropriate. Additionally, ICOE contracted with an evaluator who will assist it with the development of an evaluation framework with specific goals and objectives for the program. Education expects to finalize the framework and present it to the advisory board in February 2007.

CITY OF LOS ANGELES

Outside Counsel Costs Have Increased, and Continued Improvement in the City's Selection and Monitoring Is Warranted

Audit Highlights . . .

Our review of the Office of the City Attorney's (Attorney's Office) use of outside counsel revealed:

- The costs for outside counsel have risen from \$17.5 million to \$31.9 million over the six-year period ending in fiscal year 2004–05.*
 - The Attorney's Office lacked documents necessary to demonstrate it followed its policies and procedures when assessing the need to retain outside counsel and when performing its role in selecting outside counsel.*
 - Although its policies for monitoring the work performed by outside counsel provided sufficient direction for good case management, the Attorney's Office did not always follow them.*
 - The Attorney's Office eliminated numerous charges from outside counsel invoices, but it could improve its invoice review as it paid outside counsel for some costs its policies did not allow.*
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REPORT NUMBER 2004-136, JANUARY 2006

City of Los Angeles, Office of the City Attorney and City of Los Angeles, Office of the City Administrative Officer responses as of July 2006

The Joint Legislative Audit Committee (audit committee) directed the Bureau of State Audits to review the City of Los Angeles' (City) contracting practices for outside legal services. Specifically, the audit committee asked us to:

- Review trends in the use of outside legal services in recent years, including costs associated with outside consultants and experts.
- Assess the potential impact of legal expenses on the City's budget.
- Examine the processes the City uses for selecting outside counsel, including justification for noncompetitive processes.
- Determine whether departments sufficiently monitor the services provided by outside legal counsel and associated services such as consultants and experts.

Finding #1: The City's overall outside counsel costs have increased for various reasons.

Annual outside counsel costs for the City increased from \$17.5 million in fiscal year 1999–2000 to \$31.9 million in fiscal year 2004–05, an increase of more than 82 percent. For the six-year period, outside counsel costs totaled \$162.5 million and consisted of both legal fees (costs related to attorneys and paralegals working on cases) and expenses (other goods and services incurred by law firms, such as the costs of expert witnesses and consultants). The proprietary departments—Department of Water and Power (DWP), Los Angeles World Airports (Airports), and the Port of Los Angeles—accounted for some of the largest increases. Typically funded by revenue generated by providing services, each proprietary department is controlled by a board of commissioners rather than the city council and has control

over its own funds. The outside counsel costs for those three entities increased from \$7.9 million in fiscal year 1999–2000 to \$16.2 million in fiscal year 2004–05, an increase of \$8.3 million, or about 105 percent. DWP and Airports accounted for most of the overall increase.

The Office of the City Attorney (Attorney's Office) generally cites a lack of expertise and/or staff resources as the reason for retaining outside counsel. In an August 2004 letter outlining certain reforms regarding the use of outside counsel, the city attorney discussed the formation of an outside counsel committee responsible for reviewing and approving all requests for outside counsel. The city attorney's letter also said the committee would review trends in the use of outside counsel and recommend when it would be more prudent to build capacity and hire additional in-house attorneys and support staff. The committee was formed, and according to the Attorney's Office in October 2005, the committee considered trends in the use of outside counsel and ultimately decided to request internal staff to reduce outside counsel costs for cases involving workers' compensation, intellectual property, and labor employment.

We recommended that the Attorney's Office continue its efforts to ensure that the outside counsel committee periodically reviews trends in the use of outside counsel and make recommendations regarding areas in which it would be prudent to build capacity and hire additional in-house attorneys and support staff. The Attorney's Office should consider that information when evaluating its overall staffing needs and requesting resources.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office told us that it continues to periodically review trends in the use of outside counsel and consider this information in developing budget requests for internal resources. In addition, the Attorney's Office noted that as it begins its budget development process for fiscal year 2007–08, it intends to fully consider trends in the use of outside counsel and internal resource needs.

Finding #2: The City could improve its reporting of outside counsel costs.

Until recently, the City did not have a process to periodically and comprehensively report on the amount that it spent citywide on outside counsel costs. However, in response to questions from a city council member about the City's outside counsel costs, city staff gathered information from various departments and reported citywide information in an October 2004 memorandum (memo). The memo listed outside counsel costs by city department for fiscal years 1999–2000 through 2003–04. In August 2005 the Attorney's Office requested and subsequently received outside counsel cost data from the same departments for fiscal year 2004–05. Using the data reported in the memo and gathered by the Attorney's Office, we performed various tests on the costs paid by the General Fund and the proprietary departments, which constituted 76 percent of the total outside counsel costs over the six years reported. However, we found some significant inaccuracies and inconsistencies in the reported data we reviewed.

Since issuing the October 2004 memo, the City has taken steps that may help improve reporting of outside counsel costs. Noting that members of the city council had expressed interest in having the Attorney's Office provide a periodic report of all outside counsel costs incurred on a citywide basis, the Attorney's Office issued a letter in September 2005 asking city departments to report quarterly on outside counsel costs and to maintain all the necessary source documents substantiating cost data submitted. The letter directed departments to report costs based on payment date, which might help

address the inconsistency in reporting we noted during our review. Additionally, the letter asked departments to designate an outside counsel coordinator, which might help decrease inaccuracies and could increase the consistency of reporting.

We recommended that the City ensure that the outside counsel costs it reports are accurate and prepared consistently and that costs are adequately supported by source documentation.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office indicated to us that it continues to ensure that outside counsel costs are reported accurately, that the cost reports are prepared consistently and supported by source documentation. In addition, the City's recent approval of staff to supplement the outside counsel oversight unit is expected to help in achieving this goal.

Finding #3: The Attorney's Office lacks necessary information to demonstrate that it follows its needs assessment policy and that its outside counsel recommendations are based on a competitive process.

After the city attorney took office in July 2001, the Attorney's Office established policies and procedures on the use of outside counsel. Those policies and procedures require the Attorney's Office first to establish a need for outside counsel and then to select a firm through either a competitive or noncompetitive process. The selection process culminates in the Attorney's Office making a recommendation to the city council or appropriate board, which makes the final contracting decision. Although the Attorney's Office's December 2001 policy, as enhanced by reforms outlined in an August 2004 memo on the use of outside counsel, are generally sound, they do not require the Attorney's Office to document how it reaches its decisions for recommending outside counsel or to prepare key documents, such as rating sheets and interview notes, when it conducts a competitive selection process. As a result, the Attorney's Office lacks the necessary documentation to demonstrate that it follows its policies and procedures when performing its role in determining the need to contract with outside counsel and selecting a law firm. The reports the Attorney's Office typically prepares and presents to the city council or appropriate board contain recommendations to contract with outside counsel. However, those reports do not provide sufficient evidence of the Attorney's Office decision-making process. Without sufficient documentation of the decision-making process that takes place within the Attorney's Office when determining the need for and selecting outside counsel, the Attorney's Office leaves itself vulnerable to criticisms that its recommendations on outside counsel are not prudent or made in a fair and objective manner.

In November 2005, after we had substantially completed our fieldwork, the Attorney's Office issued a new policy on the use of outside counsel. The policy outlines the procedures for assessing the need for outside counsel and that a brief decision memo will be generated following a request to use outside counsel. It does not specify the nature or extent of the analysis to be included in the decision memo. Further, the policy indicates that the outside counsel committee must oversee the selection process and draft a recommendation as to which firm or firms should be hired. However, it does not require the creation or retention of the documents necessary to demonstrate the fairness and objectivity of the competitive process.

We recommended that to ensure that the decisions it reaches within the outside counsel committee to retain outside counsel are justified in accordance with the policy of the Attorney's Office and to enable it to demonstrate the justification to interested parties, the Attorney's Office should ensure that it follows the new policy of preparing a memo to document each of its decisions. The Attorney's

Office should ensure that the memo sufficiently reflects the analysis used in reaching its decision to recommend the retention of outside counsel. Further, to ensure that its recommendations for contract awards are less vulnerable to criticism, the Attorney's Office should develop and implement comprehensive policies and procedures that specify standards for applying evaluation criteria such as the use of rating sheets and retaining documents.

Attorney's Office's Action: Partial corrective action taken.

The Attorney's Office, in its July 2006 response, stated that its outside counsel committee prepares memos documenting its decisions to retain outside counsel. In addition, the Attorney's Office at that time was reviewing criteria that might be useful in its outside counsel selection process and hoped to have a review sheet operational by late October 2006.

Finding #4: The Attorney's Office does not adequately document how it justifies using a noncompetitive process.

Under the city charter, the Attorney's Office has the discretion to select outside counsel in a noncompetitive manner. Noncompetitive selection still requires the approval of the city council or the appropriate board. The Attorney's Office has outlined the types of situations in which it uses a noncompetitive selection process. However, it has not established a policy for retaining the documents necessary to demonstrate its decision-making process. The Attorney's Office provided only limited documentation to justify its noncompetitive selection of outside counsel in three of the five contracts we reviewed and had no documentation for two of the selections. As a result, in an area where the Attorney's Office is particularly vulnerable to criticism—selecting outside counsel without a competitive process—it lacks all the necessary documentation to demonstrate how it made its decisions on recommending outside counsel.

In its new November 2005 policy, the Attorney's Office outlined a role for the outside counsel committee with regard to selecting outside counsel in a noncompetitive manner. The November 2005 policy states that in cases in which one firm is uniquely qualified to perform the work, or in which time is of the essence, the committee can recommend a noncompetitive selection process to award the contract. Additionally, the November 2005 policy requires the committee to oversee the drafting of a transmittal recommending to the city council or appropriate board that the firm be selected as a result of the process. However, it does not specify the nature or extent of the analysis to be included in the memo.

We recommended that the Attorney's Office make certain that the outside counsel committee follows the new policy of drafting a memo regarding the firm it recommends for selection. The Attorney's Office should ensure that the memo sufficiently reflects the analysis used by the outside counsel committee in concluding a noncompetitive selection was necessary and appropriate.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office reported that its outside counsel committee prepares memos documenting its decisions, including the decisions to retain outside counsel in a noncompetitive manner.

Finding #5: The Attorney's Office often relied on informal means to oversee its contracts with outside counsel.

The Attorney's Office's policies in place at the time of our fieldwork called for the use of recommended case management tools, such as case budgets and quarterly reports, to help control the costs of outside counsel. Although those policies provided sufficient direction for good case management, Attorney's Office staff did not always follow the policies, often relying on informal monitoring of outside counsel through telephone, e-mail, or in-person communications.

As part of its new policy on the use of outside counsel issued in November 2005, the Attorney's Office revised its standard contract language. Although we reviewed the November 2005 policy and contract, we did not evaluate the Attorney's Office's compliance with it. The November 2005 policy changed the Attorney's Office's monitoring procedures for case budgets and quarterly reports. The use of case plans continues to be discretionary under the new policy.

We recommended that the Attorney's Office require budgets and case plans. Specifically, it should ensure that contracts with outside counsel contain provisions requiring comprehensive budgets and case plans and ensure that the requirements are met. Further, to ensure that its November 2005 policy change of eliminating quarterly reports has not limited its insight into the activities of outside counsel, the Attorney's Office should periodically evaluate its process of obtaining status updates to report to the city council or appropriate board on significant outside counsel cases and modify that approach if necessary.

Attorney's Office's Action: Partial corrective action taken.

The Attorney's Office told us that its outside counsel committee requires budgets prior to retaining outside counsel and before requesting any supplemental funding for an outside counsel contract. In addition, the Attorney's Office reported that its amended outside counsel contract requires both budget and case plans. The Attorney's Office also noted that it is working on including an abbreviated status update on all quarterly financial status reports. It reported that the quarterly financial status reports will supplement the comprehensive biannual reports. In addition, the Attorney's Office told us that it will continue to evaluate the frequency of reporting to ensure that the City Council and various boards are appropriately updated.

Finding #6: The Attorney's Office's policies and procedures for reviewing outside counsel's invoices are reasonable, but it could better identify and eliminate certain questionable costs.

Although its prescribed process for reviewing outside counsel's invoices for contracts paid by the General Fund and proprietary departments is reasonable, the Attorney's Office does not consistently apply its invoicing policies and procedures. In establishing comprehensive invoicing policies and implementing a review process to ensure that outside counsel follow them, the Attorney's Office has helped control outside counsel costs. Our testing of 41 invoices demonstrated that the Attorney's Office often eliminated charges that conflicted with its policies. Nevertheless, we identified certain instances in which the Attorney's Office did not apply its invoicing policies and paid outside counsel for costs that were not allowed. Those costs were primarily related to block billing—the practice of grouping tasks and invoicing for an aggregate amount of time, rather than specifying the time spent and costs associated with each task. In addition, attorneys and paralegal staff were sometimes billed to the City without prior written approval. Although the Attorney's Office's invoicing policies seek to establish a standard for reasonable billing practices and to encourage accountability based on cost-benefit considerations, it undermines those efforts by not consistently identifying all unallowable costs. In addition, the Attorney's Office risks paying more for outside counsel than it has to or is contractually obligated to pay.

We recommended that to help control the costs of outside counsel, the Attorney's Office should enforce its contract requirements and billing guidelines. Specifically, the Attorney's Office should do the following:

- Disallow payment for invoices that it receives in a block-bill format and require that outside counsel resubmit the charges in the prescribed manner.
- Ensure the formal approval of attorneys and paralegals not previously listed on the contracts with outside counsel.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office reported that it continues to strictly enforce all billing guidelines.

Finding #7: The Attorney's Office could more efficiently and effectively monitor outside counsel costs by comparing budgeted to actual costs for activities.

The Attorney's Office could more efficiently and effectively monitor outside counsel costs if it prepared budgets detailed by activity and required outside counsel to submit invoices that had the same level of detail and could thus be compared to the budget. For cases we reviewed in which outside counsel provided budgets to the Attorney's Office, the budgets were in varying formats and showed varying levels of detail.

The Attorney's Office's December 2001 policy stated that managing attorneys should participate in the creation of a litigation budget that describes, in detail, the total estimated cost of outside counsel's assistance in a matter. The policy also directed managing attorneys to periodically compare outside counsel's actual costs against budgeted costs. However, the November 2005 revised policy states that budget updates are generally required from outside counsel as contract amendments are proposed, and managing attorneys are not required to compare budgeted costs with actual costs. Thus, it appears that reacting to the need for more funding, rather than proactive cost control, now drives budget reviews, because their use is tied to requests for supplemental funding.

Although comparing budgets against actual costs was required by the policy in effect during the period of our audit, our review of selected contracts found no evidence that Attorney's Office staff made the comparisons. Even though Attorney's Office staff ensured that total invoices did not exceed total contract costs and reviewed lengthy invoices that reflected time charged in increments as small as six minutes, this invoice review is labor intensive, and its comprehensiveness and effectiveness are limited. Comparing outside counsel costs to budgeted costs by activity within litigation or project phase should enable the Attorney's Office to better facilitate effective communication on the progress of its cases and any deviations from established budgets.

We recommended that the Attorney's Office require outside counsel to prepare monthly invoices and cumulative cost reports that sort charges both by attorney within activity and by activity within litigation or project phase. Further, the Attorney's Office should compare cumulative charges and estimated remaining charges to agreed-on budgets.

Attorney's Office's Action: Pending.

The Attorney's Office noted only that this recommendation was under review.

Finding #8: The attorney conflicts panel is generally managed appropriately, although the selection of firms for the panel could be better documented.

When the Attorney's Office has an actual or potential conflict of interest—that is, a case in which it cannot ethically represent a city employee whose interests may be adverse to those of the City—it refers the matter to the attorney conflicts panel (conflicts panel). The conflicts panel comprises law firms selected by the Attorney's Office, in conjunction with the Office of the City Administrative Officer (CAO), to provide legal services to the City in the event of a conflict of interest. The selection process culminates in a committee from the Attorney's Office (selection committee) making a recommendation to the city council, which makes the final contracting decision. The major types of litigation for the conflicts panel are cases involving police or employment issues.

In reviewing the process used to evaluate firms responding to the 2005 request for qualifications (RFQ), which took place during our audit, we concluded that the Attorney's Office could better document how it made its decisions when selecting firms to recommend for placement on the conflicts panel. The Attorney's Office has overall responsibility for the selection process, although CAO staff were involved in the process, including participating in the selection committee. It was evident that the selection committee interviewed prospective firms, but it did not sufficiently document its rationale for choosing some firms over others. As in our review of other selection processes that the Attorney's Office conducted, we found that the RFQ that was released cited evaluation criteria, in this case focusing on ability and experience, but that the selection committee could not provide sufficient documentation to support the decisions it made based on the criteria.

The contracts that the City enters into with outside counsel through the CAO contain the CAO's invoicing policy, which is comparable to the policies of the Attorney's Office. The contracts specify the frequency with which outside counsel must invoice the City and the form the invoices must take. The policy included in the contracts places restrictions on certain types of fees and expenses. In addition, the CAO has established an internal process for reviewing outside counsel invoices for compliance with its invoicing policy and disallows costs that do not comply. As a result, the CAO focuses on eliminating costs for which it is not contractually obligated to pay. Our review of 10 invoices showed that the CAO consistently followed its review process and applied its established invoicing policy by disallowing costs that were not in accordance with its policy.

The CAO's policies for monitoring cases handled by outside counsel are similar to those of the Attorney's Office in that its contracts require outside counsel to submit reports that are useful for monitoring, including budgets and quarterly status reports. The CAO's procedures manual states that the CAO is responsible for ensuring that outside counsel comply with the terms and conditions of its contracts. Our review revealed that the CAO generally has performed an adequate job of monitoring outside counsel. However, we found some contracts that did not require outside counsel to submit budgets.

In a separate finding we recommended that the Attorney's Office develop comprehensive policies and procedures that specify standards for applying evaluation criteria. With regard to the CAO and its oversight of outside counsel, we recommended that in order to help control the costs of outside counsel, the CAO should require budgets for all contracts with outside counsel that it manages.

CAO's Action: Corrective action taken.

The CAO acknowledged the importance of budgets as a mechanism for controlling outside counsel costs. The CAO stated that it will require budgets in all cases that it handles.

DEPARTMENT OF HEALTH SERVICES

Investigations of Improper Activities by State Employees, January 2005 Through June 2005

INVESTIGATION I2004-0930 (REPORT I2005-2),
SEPTEMBER 2005

Department of Health Services' response as of March 2006

Investigative Highlights . . .

Department of Health Services:

- Improperly paid contract staff \$57,788 for services it did not receive.***
 - Circumvented procurement procedures and purchased \$40,698 in equipment on a services contract.***
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We investigated and substantiated an allegation that the Department of Health Services (department), Genetic Disease Branch (branch) improperly paid a contractor for holiday time and improperly purchased equipment under personal and computer services contracts.

Finding #1: The branch improperly paid for contract staff holiday time.

We believe the branch may have violated state law prohibiting gifts of public funds by paying contract employees more than they were entitled to receive. Although terms of the contract did not require it to do so, the branch authorized payment for 13 holidays to Contractor A's staff from December 2003 through November 2004, costing the State \$57,788 for services it did not receive. The contract under which the branch made these payments specifies that services shall be provided Monday through Friday, 8 a.m. to 5 p.m., except for official state holidays.

The branch stated that effective January 1, 2004, it amended Contractor A's three contracts to provide for holiday pay and provided a holiday pay schedule developed and approved by a former branch employee. However, it was never processed through the department's contracts section, and therefore, did not constitute a formal, authorized written amendment to the contract.

Finding #2: The branch circumvented procurement procedures.

The branch circumvented state procurement procedures by using services contracts with both Contractor A and Contractor B to purchase two computers, three fax machines, and two laser printers for the branch. The computers cost \$35,000, the fax machines cost \$1,845 and the printers cost \$3,853, for a total of \$40,698.

The branch's agreement with Contractor B was for the contractor to provide maintenance of computer hardware and software. The branch circumvented the goals of state law as well as state procurement procedures by using money from this computer services contract to purchase two computers.

Specifically, the branch approved a \$15,500 invoice from Contractor B for what the invoice stated as "time and materials not covered under the terms and conditions of the regular maintenance agreement" but was actually for the cost of the two computers. We believe the information on this invoice was a misleading statement about the true nature of the transaction. Further, it appears that the branch was aware of the true nature of the amount claimed on the invoice when it approved payment, thereby not only circumventing state procurement procedures but also approving and perpetuating misleading information. The branch also approved a second invoice from Contractor B for \$19,500 containing the same description of services. The branch told us this invoice was for the installation of emergency backup computers in Sacramento, something that was necessary as part of the recovery system required for critical public health services. It further said both invoices were approved under the mistaken impression that the contract had been amended to provide for this equipment.

Similarly, the branch used a personal services contract with Contractor A to purchase fax machines and laser printers. In taking this action, the branch circumvented state procurement procedures requiring departments to first obtain price quotes and compare prices for such purchases. Furthermore, the contractor charged the branch another 10 percent for "additional administrative and accounting expenses."

Department's Action: Pending.

The department reported its corrective action and adverse action is still under review.

CALIFORNIA MILITARY DEPARTMENT

Investigations of Improper Activities by State Employees, January 2005 Through June 2005

INVESTIGATION I2004-0710 (REPORT I2005-2),
SEPTEMBER 2005

California Military Department's response as of November 2006

Investigative Highlight . . .

A supervisor with the California Military Department embezzled at least \$132,523 in state funds over an eight-year period.

We investigated and substantiated an allegation that a supervisor with the California Military Department (Military Department) embezzled public funds.

Finding: The supervisor fraudulently appropriated state funds under his control and failed to stop payments to a retired service member who had died and then stole the deceased individual's retirement checks.

Over an eight-year period, the supervisor embezzled at least \$132,523 as follows: \$111,507 from the Military Department's system for processing emergency state active duty payroll; \$12,393 from the department's revolving fund; and \$8,623 from the retired state active duty system used to process retirement payments (retirement payments). The supervisor fraudulently initiated at least 60 checks in the names of his family members totaling a gross amount of \$123,900. At least 43 of these payments, totaling \$87,483, were deposited into his bank accounts. In addition, the supervisor stole at least four retirement payments totaling \$8,623 that were payable to a former service member who had died.

Military Department's Action: Corrective action taken.

The Military Department asked the California Highway Patrol (Highway Patrol) to investigate the criminal aspects of this case. The Highway Patrol interviewed the supervisor who admitted to the embezzlement and thefts. After completing its investigation, the Highway Patrol referred the case to the Sacramento County District Attorney for prosecution. According to court records, the supervisor was charged with and convicted on two felony counts, including grand theft and embezzlement, and was ordered by the Sacramento Superior Court (Court) to pay court costs and fees of \$410 and to make restitution to the State in the amount of \$132,523, the amount we identified that he embezzled. Finally, the Court sentenced the supervisor to 16 months in state prison.

STATE ATHLETIC COMMISSION

The Current Boxers' Pension Plan Benefits Only a Few and Is Poorly Administered

REPORT NUMBER 2004-134, JULY 2005

Audit Highlights . . .

Our review of the State Athletic Commission (commission) and the boxers' pension plan revealed that:

- Under the current plan only four boxers per year are vesting.*
 - The current plan will likely give an average 55-year-old vested boxer a pension benefit of \$170 per month, while the original plan would have paid \$98 per month.*
 - During the four-year period from 2001 through 2004, payments for pension plan administration costs were six times greater than the amount of benefits paid to boxers.*
 - Since the inception of the current plan, the commission met the minimum funding requirement in only one out of nine years.*
 - Poor administration of the pension plan resulted in untimely recording of pension contributions, inaccurate reporting of boxers' eligibility status, and incorrect account balances.*
-

State Athletic Commission's response as of August 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the State Athletic Commission's (commission) pension plan operations. Specifically, the audit committee was interested in the condition of the current plan, the best course of action to ensure its long-term viability, how much is being spent on administrative expenses, and whether the statutory requirements for pension contributions and benefit distributions are being met. In doing so, we noted the following findings:

Finding #1: Although potentially more generous than the original plan, the current pension plan benefits even fewer boxers.

Combining both the defined benefit plan (original plan) and the defined contribution plan (current plan), only 14 percent of licensed boxers have vested as of December 31, 2003, and account balances for most vested boxers are small. Under the current plan, which began in May 1996, only four boxers per year are vesting compared to 37 boxers per year vesting under the original plan. If the current vesting trend continues, the remaining number of vested boxers will plateau at below 80 in 2036. Although vested boxers currently approaching retirement age are likely to receive more benefits than the original plan guaranteed, pension amounts will still be minimal. The current plan will likely give an average 55-year-old vested boxer a pension benefit of \$170 per month, while the original plan would have paid \$98 per month. From 2001 to 2004, benefit payments to boxers totaled \$36,000 while the payments to administer the plan were six times higher.

We recommended that the Legislature may want to reconsider the need for a pension plan for retired professional boxers since so few boxers annually meet the current criteria of a professional boxer. If the Legislature decides to continue the boxers' pension plan, we recommended that the commission could consider eliminating the break in service requirement and/or reducing from four to three the number of calendar years that a boxer must fight, if it believes the current vesting criteria is excluding

professional boxers for which the pension plan was intended. Further, the commission should mail an annual pension statement to all vested boxers to increase the likelihood that vested boxers are locatable for benefit distribution after they turn age 55.

Commission's Action: Partial corrective action taken.

In order to ensure that the pension plan provides benefits to the professional boxers that were intended, by September 15, 2006, the executive officer expected to complete his review of alternative vesting criteria that would give consideration to a boxer's age (i.e., actual age, number of years boxing, total actual number of rounds fought, number of times knocked out, number of times suspended, etc.). To increase the likelihood that vested boxers are locatable after they turn age 55, the commission plans to send each boxer an annual statement regardless of activity status. For any annual statements that are returned as undeliverable, it will resend the statement to any secondary address that may be available.

Finding #2: The commission has many problems with its day-to-day administration of the boxers' pension plan.

The boxers' account balances of \$3.39 million could have been higher had the commission fully exercised its legal authority to maximize contributions to the current plan. Although the commission increased the ticket assessment to 88 cents per ticket in July 1999, it only met the target in one of nine years and has undercollected by a total of \$300,000. Additionally, the commission performs its administrative duties related to the boxers' pension fund slowly and inaccurately. We found problems with untimely depositing of incoming checks to the Department of Consumer Affairs' (Consumer Affairs) bank account, remittances of pension contributions to the boxers' pension fund, and production of accurate eligible round and purse information; missing boxing contest documents needed to support contribution allocations to boxers; and various errors in determining boxers' eligibility and allocation of amounts to boxers' accounts. As a result, the recording of pension contributions were delayed, boxers' eligibility status were inaccurate and their respective account balances were incorrect. Moreover, the commission needs to periodically review boxers' eligibility status and account balances to ensure that the pension plan administrator correctly determines boxers' eligibility and account balances.

To maximize pension fund assets, we recommended that the commission should raise the ticket assessment to meet targeted pension contributions as required by law and promptly remit pension contributions from Consumer Affairs' bank account to the boxers' pension fund. To ensure receipts are deposited in a timely manner, we recommended the commission should implement the corrective action proposed by the acting executive officer to Consumer Affairs related to ensuring timely deposit of checks. Additionally, the commission should require promoters to remit pension fund contributions on checks separate from other boxing show fees so that deposits of checks and subsequent remittances to the boxers' pension fund are not delayed. To ensure boxers' information concerning eligibility status and pension account balances are accurate, the commission should retain all official documents from each boxing contest. Further, the commission should immediately work with the pension plan administrator to correct errors related to boxers' eligibility status and account balances. Lastly, the commission should periodically review a sample of newly vested and pending boxers, and verify their eligibility status and pension account balances.

Commission's Action: Partial corrective action taken.

The commission is considering various alternatives to meet the funding target, including negotiating with tribal governments to collect contributions from fights on tribal lands, redirecting some broadcast revenues to the pension fund, and raising the per ticket assessment to \$1.25. The commission has taken steps to ensure that previously collected pension contributions have been deposited in the pension fund and that future collections are deposited in the pension fund in a timely manner. One of these steps is directing promoters to remit checks for pension contributions separate from checks related to show fees. In order to ensure eligibility information is being retained, the commission has created and is using a checklist of all documents that are required to be retained in its files. The commission is in the process of completing its research related to correcting errors in boxers' eligibility status and account balances and anticipated it would finish this review by December 12, 2006.

DEPARTMENT OF GENERAL SERVICES

Opportunities Exist Within the Office of Fleet Administration to Reduce Costs

REPORT NUMBER 2004-113, JULY 2005

Audit Highlights . . .

Our review of the Office of Fleet Administration (Fleet) within the Department of General Services found that:

- Fleet's analyses, indicating that its vehicle rental rates are competitive with those of commercial rental companies, do not fully demonstrate its cost-effectiveness because Fleet lacks assurance that the commercial rates it used are similar to what state agencies typically pay.*
- The terms of the current contracts that Fleet has with commercial rental companies and the noncompetitive method it uses to select companies may not be in the State's best interest.*
- Fleet currently lacks a minimum-use requirement for vehicles that state agencies rent on a long-term basis as well as standards related to the idleness of its short-term rental vehicles, both of which could identify opportunities to reduce the number of vehicles in its motor pool.*

continued on next page . . .

Department of General Services' response as of July 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) conduct an audit of state-owned vehicles with a focus on the cost-effectiveness of the garages that the Office of Fleet Administration (Fleet) within the Department of General Services (General Services) operates. Specifically, the audit committee asked the bureau to determine whether General Services has a process in place to measure the cost-effectiveness of its garages and fleet of rental vehicles and, to the extent possible, determine whether it is cost-effective for the State to own, maintain, and rent its vehicles and own and operate its garages. Additionally, the audit committee asked the bureau to evaluate the potential for cost savings resulting from no longer having Fleet own and maintain vehicles and the potential savings from the consolidation and/or disposition of state-operated garages. Finally, the audit committee asked the bureau to review and evaluate General Services' policies and procedures for ensuring the accountability of state vehicle purchases, including the controls in place to monitor vehicle purchases and determine whether other state agencies purchase motor vehicles in accordance with applicable requirements and in the best interest of the State. We found the following:

Finding #1: Fleet's analyses of its cost-effectiveness indicate that it is competitive, but its analyses are limited.

To measure its cost-effectiveness, Fleet periodically compares its rates to those of commercial rental companies. The commercial rental rates used in the analyses were generally either rates, obtained through the Internet or by telephone or e-mail, that the companies offered to the general public at individual locations in the State or the maximum rates that the companies have agreed to in their contracts with Fleet. When Fleet compared the two amounts for each vehicle type, the comparisons indicated that its rates are competitive with those that commercial rental companies offer and that state agencies save money by using Fleet's services when they are available.

- ☑ *Fleet is responsible for overseeing the vehicle purchases made by state agencies, but its policy defining minimum usage, which Fleet is supposed to consider when assessing a state agency's need to purchase vehicles, may be set too low.*
 - ☑ *Fleet's actions contributed to a \$1.4 million deficit at June 30, 2004, in the fund that Fleet uses to operate and maintain parking lots for state employees.*
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However, Fleet lacks assurance that the rates state agencies typically pay are similar to the companies' public rates because state agencies are generally required to rent vehicles using the contracts that Fleet has with commercial rental companies; therefore, state agencies would pay the rates offered under the terms of Fleet's contracts. Further, the maximum contract rates used in earlier analyses do not provide for a meaningful comparison because, as Fleet acknowledges, commercial rental companies do not typically charge such high rates.

A more comprehensive way to measure Fleet's cost-effectiveness would be to compare Fleet's costs to operate the motor pool to how much the State would spend using commercial rental companies, considering the rates that the companies typically charge the State. Fleet's contracts with commercial rental companies require them to submit quarterly data to Fleet that could help it determine how much the companies charge state agencies for their services. However, the reports that Fleet receives do not currently identify the average monthly, weekly, or daily rental rates the companies charge by vehicle type. If Fleet required its contractors to report information that would help it determine how much state agencies typically pay, those amounts would be a better basis of comparison.

We recommended that in addition to rate comparisons, Fleet should compare the actual cost of operating its motor pool to the amount that the State would pay commercial rental companies. In doing so, Fleet should use the actual motor pool rental activity, such as the number of days or months that it rents vehicles by each vehicle type, and apply it to rates that commercial rental companies actually charge state agencies. To understand how much state agencies typically pay when using the services of contracted commercial rental companies, Fleet should require, through its contracts, that the companies report information on vehicle rentals that would enable Fleet to determine the average daily or monthly rate actually charged for each vehicle type.

General Services' Action: Partial corrective action taken.

General Services reports that it has worked to obtain additional management information from its automated fleet management information system. Thus, Fleet is now able to more accurately compare the actual cost of operating its motor pool to the amounts that commercial rental companies charge state agencies. Additionally, according to General Services, it entered into new commercial car rental contracts that began on January 1, 2006, which include provisions for the receipt of information on actual charges incurred for the daily and weekly leasing of vehicles. General Services states that it will use this information in future cost-effectiveness studies.

Finding #2: Existing contracts raise questions as to whether they are in the best interest of the State.

We question whether the contract terms and the noncompetitive method that Fleet uses to select commercial rental companies result in contract rates that are as beneficial to the State as they could be. According to Fleet's chief, the intent of the contracts is to ensure that state employees renting vehicles from commercial rental companies are protected against companies charging them whatever they want. However, the amounts that commercial rental companies actually charge can be significantly lower than the maximum rates specified in the contracts.

An individual representing two of the seven companies with which Fleet contracts stated that Fleet requires the maximum rates in the contracts to encompass all fees such as airport or county fees and that this must be carefully considered as these fees are out of his companies' control. Further, he said that the contract rates have a large cushion built in to protect against vehicle price increases that could occur over the potentially long contract term. Although its contracts are for one year, Fleet can twice exercise the option to extend a contract for one year.

Fleet also requires commercial rental companies to insure the vehicles while state employees drive them, which raises rates. Fleet does not know if this requirement is in the State's best interest because it has not conducted an analysis and could not tell us the cost that insurance adds to commercial rental rates in Fleet's contracts. For example, it has not compared the cost of insuring cars through the commercial rental companies to the costs of other methods, such as self-insuring. If the State is able to self-insure commercially rented vehicles or purchase insurance for less than what it pays through its existing contracts, the rates that commercial rental companies offer the State could decrease significantly.

While still renting under Fleet's contract with one rental company, at least one state agency has an agreement with the company to guarantee lower rates than those specified under the company's contract with Fleet. Such agreements indicate that a more competitive process of selecting contractors may result in lower rates to the State. Because Fleet does not offer the State's business exclusively to one or two companies, contractors may not have an incentive to offer a lower rate during the contract proposal process.

Fleet acknowledges that a more competitive method of selection that would not limit availability of services could result in lower rates. In May 2005, the chief told us that Fleet was exploring a new option for state travelers that would employ competitively bid rental contracts with awards made to a primary and secondary commercial rental company. She also said that Fleet planned to contract for the base cost of vehicles (the cost before additional fees such as airport fees) to recognize the fees that vary by location.

We recommended that before seeking additional commercial rental contracts, Fleet should do the following:

- Determine if it can obtain lower guaranteed contract rates for the State by evaluating the extent to which using contracts that contain extension options contributes to maximum contract rates that are significantly higher than rates that the commercial rental companies could charge.

- Determine if paying for insurance when renting vehicles from commercial rental companies rather than other methods, such as self-insurance, is in the best interest of the State.
- Continue its efforts to obtain lower rates from commercial rental companies by pursuing options for a more competitive contracting process.

General Services' Action: Partial corrective action taken.

According to General Services, Fleet pursued a competitively bid process that allowed for awards to be made to one primary and one secondary car rental company instead of the previous system whereby seven different companies provided services to the State's employees. General Services states that the contracts it awarded, which are for January 2006 through December 2008, should save the State about \$3 million in each of the three years. Additionally, according to General Services, unlike the contracts in place during the audit, the new commercial car rental contracts do not allow the contracted rental car company to charge customers any amount up to a maximum rate identified in their contracts. Instead, the awarded contracts require rental charges to be based on guaranteed set rates. Moreover, General Services told us that the Office of Risk and Insurance Management helped Fleet determine the bidder proposal that represented the best value to the State.

Finding #3: Fleet has not established certain requirements and standards related to vehicle use.

Although Fleet has established a minimum-use policy to ensure that state agencies efficiently operate the vehicles they own, it has no such requirement for vehicles that state agencies rent from the motor pool on a long-term basis. Without such a utilization policy, Fleet cannot ensure that its motor pool is used optimally.

By not requiring state agencies to meet a minimum-use requirement for long-term rentals, Fleet may in effect be allowing state agencies that cannot justify vehicle purchases based on usage to obtain vehicles by renting them from Fleet on a long-term basis. Since the function of a minimum-use requirement is to minimize costs, the absence of such a policy can result in higher costs to the State.

In addition to not establishing a minimum-use requirement for its long-term rentals, Fleet has not developed performance measures to determine if the vehicles that it rents on a short-term basis are idle an excessive number of days. Best practices indicate that fleet managers should set policies and develop performance measures to ensure that their fleets consist of the appropriate number of vehicles in the appropriate composition.

In May 2005, Fleet's chief told us that Fleet is putting in place a method for collecting and analyzing data for a minimum-use requirement that will be identical to the requirement for agency-owned vehicles. Fleet expected to make its policy effective in July 2005. The chief also told us that it was developing performance standards to better assess utilization and idle time. Once Fleet establishes these standards, it can monitor its performance and identify opportunities to reduce the number of vehicles it owns.

To ensure that the vehicles in Fleet's motor pool are being used productively, we recommended that Fleet should continue its efforts to establish a minimum-use requirement for the vehicles it rents to state agencies on a long-term basis and should ensure that state agencies follow the requirement or justify vehicle retention when they do not meet the requirement. Additionally, for its short-term pool, Fleet should continue to develop performance standards to better assess vehicle utilization and idle time.

General Services' Action: Partial corrective action taken.

General Services reports that in January 2006 it issued a Management Memorandum that revised the minimum vehicle use criteria for vehicles it leases to state agencies on a long-term basis. The criteria are now a minimum of 6,000 miles or 80 percent of workdays within a six-month period. General Services states that it is now using the same minimum usage standards to assess utilization and idle time of the short-term vehicle pool.

Finding #4: Fleet does not analyze its costs by vehicle type.

Fleet does not analyze its costs by vehicle type and therefore cannot readily identify vehicles that are not cost-effective to own. It is important for Fleet to understand its costs to manage the motor pool and ensure that the motor pool's composition of vehicles is not costing the State more than is necessary. Potentially, Fleet could reduce its costs by limiting the types of vehicles that it has available.

If Fleet finds that the cost of owning a specific vehicle type significantly exceeds the rate it charges, it could make decisions to align the rate with its costs. Further, if Fleet determines that owning a specific vehicle type costs more than state agencies will spend by using alternatives to the motor pool, Fleet could make decisions to eliminate or limit those types of vehicles. We recognize that the decisions Fleet makes regarding the composition of its motor pool may consider other factors, such as the needs of state agencies for particular types of vehicles. However, if Fleet analyzed its costs by vehicle type, it could better ensure that it is meeting the needs of the state agencies it serves in the most cost-effective manner.

According to its chief, as of May 2005, Fleet was working to develop a feasibility study report for a fleet management system. She expected this system to provide reports that will include information to help Fleet calculate costs by vehicle type, such as fuel use by vehicle type and repair and maintenance costs by vehicle type. The chief also told us that Fleet was in the process of incorporating additional performance measures related to costs by vehicle type to identify other opportunities for cost savings.

We recommended that to ensure that the composition of its motor pool is cost-effective, Fleet should continue its efforts to obtain costs by vehicle type. It should consider this information in its rate-setting process as well as in its comparisons to the costs of alternatives to the motor pool.

General Services' Action: Partial corrective action taken.

According to General Services, Fleet is continuing to take significant actions to obtain the necessary information to determine the actual cost of its motor pool operations and the actual usage of its motor pool. Specifically, Fleet developed a new system that provides for employee time charges to be captured in a manner that provides more useful information on tasks performed in both inspection and garage operations. In addition, General Services states that Fleet has developed management reports that identify costs by vehicle type and plans to consider this information in the development of vehicle rates and in comparisons to the costs of alternatives to the motor pool.

Finding #5: Fleet does not periodically assess the cost-effectiveness of individual garages.

Although Fleet operates several garages throughout the State, it does not periodically analyze the revenues and expenses incurred at each garage. Consequently, Fleet does not know if any of its garages are operating at a loss. In fact, Fleet's accounting system does not track most revenues and expenses for its vehicles by their respective garages. Although Fleet tracks certain revenues and expenses, such as tire sales and certain personnel costs by garage location, it does not track the revenue from vehicle rental fees and certain expenses, such as most of Fleet's depreciation, fuel, and insurance expenses, for the individual garages. Instead, Fleet tracks them in the aggregate for all garages.

With its current accounting system, Fleet can determine if its garages as a whole are operating at a break-even point, but it lacks the necessary information to determine the cost of operating each garage. Consequently, Fleet could unknowingly be operating a garage that costs more than the garage generates in revenue. Additionally, Fleet cannot use its accounting system to determine if the State would pay less if it closed one or more garages and obtained the garages' services from alternative sources. As of April 2005, Fleet was reviewing ways to modify the accounting system so that it tracks the revenues earned at each garage and provides Fleet the financial information necessary to analyze each garage.

To ensure that it does not operate garages in areas where alternative methods of transportation, such as vehicles from commercial rental companies, would be less expensive to the State, we recommended that Fleet examine individual garages to determine whether it is cost-effective to continue operating them. Fleet should consider all relevant factors, such as the frequency with which it rents vehicles on a short-term basis, the ability for other garages to take long-term rentals, and the cost-effectiveness of its repair and maintenance services.

General Services' Action: Partial corrective action taken.

General Services states that it has developed additional utilization and cost data that will assist in judging the efficiency and effectiveness of its garages. Additionally, General Services reports that Fleet has taken other significant actions to improve its ability to adequately monitor the efficiency and effectiveness of garage operations. Specifically, Fleet reorganized its garage operations and hired a new manager over those operations who has a strong background in managing fleet programs, including the gathering of data that will allow the cost-effectiveness of the individual garages to be more accurately evaluated.

Finding #6: Fleet does not measure the cost-effectiveness of its repair and maintenance services.

Fleet provides maintenance and repair services to its motor pool and agency-owned vehicles at its garages. However, Fleet does not adequately track its labor costs and therefore does not know how much it actually costs to perform each of the services it provides. As a result, Fleet cannot fully assess its competitiveness. Fleet needs to know the cost of the specific services it provides to make decisions about which services to outsource or perform in-house and which garages to close, consolidate, or expand.

Although labor represents a significant cost for Fleet's garages, Fleet does not determine how much time it spends performing various maintenance and repair services, such as changing oil or servicing transmissions. Fleet employs technicians who perform these services, but it does not require them to allocate their time to specific tasks. If Fleet tracked labor hours by task through its timekeeping system, it could use that data and the information it maintains in its fleet database to determine the labor required to perform each service. Without knowing the labor costs of its services, Fleet cannot determine if the State is spending less to perform repair and maintenance services than it would spend at commercial repair shops.

In May 2005, Fleet's chief told us that measuring its cost-effectiveness is a Fleet priority and that by September 2005 Fleet anticipated implementing a timekeeping system that would allow it to track the amount of time staff spend performing tasks. With that information, Fleet will be able to analyze which tasks it can perform more cost-effectively than commercial repair shops can and if the current ratio of in-house repairs to repairs performed by commercial repair shops is optimal.

We recommended that Fleet should continue with its plan to track the time of its garage employees by task to determine the cost of its repair and maintenance services and that Fleet should compare its costs to the amount that commercial repair shops would charge for the services.

General Services' Action: Partial corrective action taken.

General Services told us that a new system for tracking tasks was installed for use within Fleet in October 2005. According to General Services, garage staff and Fleet's asset management staff were trained and actively began using the new system in January 2006. General Services states that as sufficient historical data becomes available, the resulting information will be used within future cost-effectiveness studies.

Finding #7: Opportunities exist to improve Fleet's purchase approval process.

To ensure that state agencies do not make unnecessary vehicle purchases, state law requires Fleet to verify that the state agencies need the vehicles before it approves purchase requests. Fleet has made changes to strengthen its purchase process that have improved the amount of information that state agencies submit to justify their vehicle purchase requests; however, more changes are needed.

Until February 2003, Fleet's policy was to require an agency submitting a purchase request for one or more vehicles to explain the agency's need for the vehicles, but in practice it required no standard form or type of information for new purchases. In February 2003, Fleet introduced a standard form for vehicle purchase requests, specifically requiring state agencies to explain

their needs. After improving the form in October 2003, Fleet now requires state agencies to explain how and where the vehicle will be used; why a special vehicle, rather than a standard sedan, is required; and whether the need for the vehicle is urgent. When state agencies provide this additional information, Fleet is able to complete a more thorough, meaningful assessment of need.

Although the new form has resulted in Fleet's receiving more detailed explanations of why state agencies need to purchase vehicles, Fleet still does not require state agencies to report why any underutilized vehicles they might have cannot fulfill their needs. Consequently, if it is to make a thorough assessment of need, Fleet must follow up with the state agencies. By requiring state agencies to explain in writing why their underutilized vehicles are not adequate to meet their needs, Fleet not only would reduce the amount of follow-up it must perform but also could better ensure that state agencies consider increasing utilization of the vehicles they currently own before they request to purchase additional vehicles.

To improve its review of vehicle purchase requests and the related documentation that it receives, Fleet should continue using its new request form with an amendment requiring state agencies to explain, on the request form, why any underutilized vehicles they might have could not fulfill their requests.

General Services' Action: Partial corrective action taken.

General Services stated that it issued in January 2006 a Management Memorandum that requires state agencies requesting vehicle purchases to provide more detailed information on their underutilized vehicles as part of Fleet's acquisition request review and approval process. According to General Services, this information is to include explanations on why any underutilized vehicles that may exist cannot fulfill the agency's needs and a certification from the agency's fiscal officer that the requested acquisition is the most cost-effective solution to meet the agency's transportation needs.

Finding #8: Fleet's minimum-use requirement for state agencies may be too low.

To ensure that state agencies do not purchase more vehicles than they need, Fleet set a policy that an agency-owned vehicle must be driven at least 4,000 miles or 70 percent of the workdays every six months. A policy requiring that state-owned vehicles be driven a minimum number of miles or days is critical to ensuring that the State's vehicles are an economical method of transportation. Once a state agency owns a vehicle, the head of that agency is responsible for ensuring that it meets the minimum-use requirement. Nevertheless, if a state agency has underutilized vehicles, as defined by Fleet's policy, Fleet may not allow the agency to purchase additional vehicles.

The State's minimum-use requirement provides a level of assurance that state agencies maximize the economic potential of their vehicles. However, Fleet's policy on minimum miles is less demanding than the policies of some other governments. The National Association of Fleet Administrators, a professional society for the automotive fleet management profession, performed a survey of fleet operators in 2003 asking participants how many miles they required their vehicles to be driven in a year. On average, government respondents required vehicles to be

driven 10,000 miles each year, 25 percent more than Fleet's policy; and on average, commercial respondents required vehicles to be driven 15,000 miles, nearly 88 percent more than Fleet's policy of 4,000 miles every six months, which equates to 8,000 miles each year.

Further, Fleet could not tell us how it developed its minimum-use requirement. Its policy is the same as it was 20 years ago. Consequently, Fleet cannot demonstrate that the requirement was set appropriately or that it is still applicable. Fleet's chief told us in May 2005 that Fleet was reviewing public-sector guidelines for fleet utilization in other states nationwide and would revise the policy in the near future.

Fleet should continue with its plan to revisit its minimum-use requirement for agency-owned vehicles to determine if the minimum number of miles or days that state agencies must drive their vehicles should be higher. When doing so, Fleet should consider factors such as the cost of alternative modes of transportation and warranty periods. Finally, Fleet should document the reasons for any decisions it makes.

General Services' Action: Partial corrective action taken.

General Services reports that Fleet completed its review of minimum use requirements and in January 2006 General Services issued a Management Memorandum advising state agencies of new criteria governing the minimum use of all vehicles. The minimum-use requirements increased to a minimum of 6,000 miles or vehicle use of 80 percent of workdays within a six-month period. According to General Services, it developed the new criteria after reviewing the minimum-use requirements used by the federal General Services Administration and nine other states.

Finding #9: Fleet inadequately managed parking lot funds.

Fleet manages approximately 30 parking lots owned or leased by General Services as of May 2005 and is responsible for administering state parking policies. Through this parking program, state employees can obtain parking spaces in lots near state offices for their cars or bicycles. Fleet deposits the fees that it charges state employees for the parking spaces into its Motor Vehicle Parking Facilities Money Account (parking fund), which it draws on to operate and maintain the lots. In recent years, Fleet's inadequate management of its parking program has caused the parking fund to lose money. The parking fund experienced losses in at least two recent fiscal years (2002–03 and 2003–04), and at the end of fiscal year 2003–04 had a deficit of \$1.4 million. Although various factors contributed to the fund deficit, we focused on two that were within Fleet's control.

Contributing to the parking fund's losses is an agreement that Fleet has to purchase transit passes from a vendor to shuttle people free of charge from parking lots on the perimeter of downtown Sacramento (peripheral lots) to locations nearer their work sites. This agreement costs more than the peripheral lots are capable of generating in revenue, given the current rate structure, and it makes up a significant percentage of the parking fund's total expenses. Fleet's chief told us that in the near future, Fleet intends to stop paying the entire cost of shuttling passengers to and from peripheral lots.

Another factor contributing to the parking fund's losses is Fleet's failure to collect fees from more than 400 parkers. According to Fleet's parking and commute manager, Fleet staff discovered, while investigating the parking fund's losses, that many individuals either never had or at some point stopped having parking fees deducted from their paychecks. In addition to individuals, some state agencies also had not paid fees for parking vehicles they owned in Fleet's lots. After completing a reconciliation that it started in November 2004, Fleet identified roughly 400 parkers who were actively using their parking

passes without paying. According to Fleet's parking and commute manager, the fees for those spaces amount to \$24,500 per month in revenue. However, Fleet was uncertain as to how long the oversight had occurred or how many more parkers who no longer have parking passes were involved.

The chief of Fleet explained that these errors went unnoticed because Fleet maintains data on parkers in three databases and did not begin reconciling the information with the amount of fees it collected until November 2004. Fleet has developed a process to reconcile its parking database information with its revenue on a monthly basis. Such reconciliation should help detect these problems should they recur in the future.

To ensure that it does not subsidize employee parking, Fleet should continue with its plan to stop paying the full cost of shuttling parkers to and from peripheral lots. Additionally, Fleet should, to the extent possible, seek reimbursement from parkers who have not paid for their parking spaces.

To reduce the deficit in the parking fund, Fleet should continue with its efforts to reduce expenses and maximize revenues from parking facilities by promptly identifying parking spaces that become available and renting them again.

General Services' Action: Partial corrective action taken.

According to General Services, since September 1, 2005, the parking fund administered by Fleet has not been used to purchase transit passes to shuttle parkers to and from peripheral parking lots. General Services also indicates that, based upon Fleet's comprehensive evaluation of information on potential nonpaying parkers that it developed in November 2004, it identified 49 parkers as owing unpaid parking fees of about \$45,000. General Services commented that, as of January 2006, each of the 49 employees had either paid their outstanding balance or established a monthly repayment plan. Further, General Services states that Fleet has implemented additional procedures to ensure that parking funds are maximized. As part of this process, Fleet is continuing to fill parking spaces the same week as they become vacant except in the peripheral lots.

PHARMACEUTICALS

State Departments That Purchase Prescription Drugs Can Further Refine Their Cost Savings Strategies

REPORT NUMBER 2004-033, MAY 2005

Audit Highlights . . .

Our review of the State's procurement and reimbursement practices as they relate to the purchase of drugs for or by state departments revealed the following:

- Although the Department of General Services (General Services) generally got the best prices for the drug ingredient cost because of up-front discounts, it had the highest state cost after considering rebates, dispensing fees, co-payments, and third-party payments.*
- The Department of Health Services' net drug ingredient cost and state cost are lower than General Services and the California Public Employees' Retirement System's (CalPERS) because it receives substantial federal Medicaid program and state supplemental rebates.*
- Although CalPERS receives rebates through entities it contracts with to provide pharmacy services to its members, it cannot directly verify it is receiving all of the rebates to which it is entitled.*

continued on next page . . .

California Public Employees' Retirement System and the Department of General Services' responses from the State and Consumer Services Agency, and the Department of Health Services' response from the Health and Human Services Agency as of May 2006

Chapter 938, Statutes of 2004, required the Bureau of State Audits (bureau) to report to the Legislature on the State's procurement and reimbursement practices as they relate to the purchase of drugs for or by state departments, including, but not limited to, the departments of Mental Health, Corrections and Rehabilitation, the Youth Authority (Youth Authority), Developmental Services, Health Services (Health Services), and the California Public Employees' Retirement System (CalPERS). Specifically, the statutes required the bureau to review a representative sample of the State's procurement and reimbursement of drugs to determine whether it is receiving the best value for the drugs it purchases. The statutes also required the bureau to compare, to the extent possible, the State's cost to those of other appropriate entities such as the federal government, Canadian government, and private payers. Finally, the bureau was required to determine whether the State's procurement and reimbursement practices result in savings from strategies such as negotiated discounts, rebates, and contracts with multistate purchasing organizations, and whether the State's strategies result in the lowest possible costs. The bureau examined the purchasing strategies of the three primary departments that contract for prescription drugs—the Department of General Services (General Services), Health Services, and CalPERS. We found that:

Finding #1: In some instances, CalPERS cannot directly verify that it is receiving all of the rebates to which it is entitled.

Negotiating drug rebates is one tool available to reduce drug expenditures. Drug manufacturers typically offer rebates based on the extent to which health care plans influence their products' market share. Although CalPERS does not directly contract with drug manufacturers, it receives rebates from some entities it contracts with

- ☑ *In our comparison of 57 prescription drug costs across the three state departments and select U.S. and Canadian governmental entities, the Canadian entities got the lowest prices about 58 percent of the time. However, federal law strictly limits the importation of prescription drugs through the Food, Drug, and Cosmetic Act whose stringent requirements generally exclude any drugs made for foreign markets.*
-

for pharmaceutical services. In some instances CalPERS receives rebates under a pass-through method. In the pass-through method, the entity negotiates rebates and contracts with pharmaceutical manufacturers so that rebate payments between the manufacturer and the entity are based on historical and prospective pharmacy utilization data for all of the members of the health care plan that the entity administers. The entity then collects and passes through to plan sponsors, such as CalPERS, either a percentage or the entire amount of the rebates earned by the sponsors based on their member utilization.

Typically, these entities prohibit CalPERS from having access to any information that would cause them to breach the terms of any contract with the pharmaceutical manufacturers to which they are a party. Because CalPERS does not have access to the entities' rebate contracts with the manufacturers, CalPERS cannot directly verify that it is receiving all of the rebates to which it is entitled. According to CalPERS, this rebate practice between the entity and the manufacturer is an industry practice and is not unique to it. CalPERS intends to continue to pursue greater disclosure requirements in future contracts with its contracting entities.

We recommended that the Legislature consider enacting legislation that would allow CalPERS to obtain relevant documentation to ensure that it is receiving all rebates to which it is entitled to lower the prescription drug cost of the health benefits program established by the Public Employees' Medical and Hospital Care Act. Additionally, CalPERS should continue to explore various contract negotiation methods that would yield more rebates for the drugs it purchases and that would allow it to achieve greater disclosure requirements to verify that it is receiving all of the rebates to which it is entitled.

Legislative Action: Unknown.

CalPERS' Action: Corrective action taken.

CalPERS reports that the providers for two of its HMO plans will furnish rebate information as part of the financial statements that they regularly provide. CalPERS also stated the provider of another of its HMOs considers rebates proprietary and confidential, and the provider does not identify rebates in its financial statements. However, a pharmacy carve-out analysis, conducted by a consultant for pharmacy claims from May 2003 through April 2004, confirmed that this HMO's management of the pharmacy benefit is the most cost-effective of CalPERS' health plans. CalPERS stated that it will continue to assess this HMO's performance and management as part of its recurring rate analysis.

CalPERS also reports that it entered into a three-year contract with a new pharmacy benefits manager (PBM) for its self-funded PPO plans. The term of the contract is from July 2006 through June 2009. According to CalPERS, this contract contains extensive provisions regarding guarantees, rebates, transparency, disclosure, and cost accountability. Because CalPERS has only received the first quarterly payment of rebates and guarantees under the new contract, it cannot yet quantify the additional savings the contract will generate. However, CalPERS expects that the total rebate payment will be twice what it received under its contract with the prior PBM based on its first quarterly payment. CalPERS stated that its new contract also requires the PBM to provide a profit and loss report specific to the CalPERS account within 30 days of the end of each contract year, and allows a CalPERS representative to audit this report.

Finding #2: General Services is in the early stages of its direct negotiations with manufacturers and aims to increase its ability to reduce the net ingredient cost of prescription drugs.

Although rebates typically decreased the cost of prescription drugs for Health Services and CalPERS, General Services' net ingredient costs, drug ingredient cost minus any rebates or additional discounts, for the drugs in our sample are about the same as its costs for the drugs before any discounts or rebates. General Services says this is because it is still in the early stages of its direct negotiations with manufacturers to achieve reduced drug costs. Currently, departments purchasing drugs through General Services can obtain rebates only for one drug product class, a rebate General Services obtained through contract negotiation efforts. For that one drug product class, state agencies received at least \$1.5 million in rebates for their purchases in fiscal year 2003–04.

To ensure that state departments purchasing drugs through General Services' contracts are obtaining the lowest possible drug prices, we recommended that General Services seek more opportunities for departments to receive rebates by securing more rebate contracts with manufacturers.

General Services' Action: Partial corrective action taken.

General Services reports that to obtain the best and lowest drug price, its primary strategy continues to be to negotiate price discounts upfront with the manufacturer. However, General Services notes that if rebates result in the State obtaining the best and lowest prices, they have been and will continue to be pursued.

Finding #3: Although General Services has made progress, it still needs to negotiate more contracts with drug manufacturers.

In a January 2002 report, *State of California: Its Containment of Drug Costs and Management of Medications for Adult Inmates Continue to Require Significant Improvements*, the bureau recommended that General Services increase its efforts to solicit bids from drug manufacturers to obtain more drug prices on contract. At that time, General Services had about 850 drugs on contract, but during most of fiscal year 2003–04 had only 665 drugs on contract. General Services states

that because of limited resources, it is focusing on negotiating contracts with manufacturers of high-cost drugs. However, opportunities still exist for General Services to increase the amount of purchases made under contract with drug companies.

We recommended that General Services continue its efforts to obtain more drug prices on contract by working with its contractor to negotiate new and renegotiate existing contracts with certain manufacturers.

General Services' Action: Partial corrective action taken.

General Services reports that its strategic sourcing contractor and its partners are providing support to General Services in its efforts to negotiate and renegotiate contracts with drug manufacturers. Specifically, the contractor has assisted General Services, as needed, in the negotiation of new and renegotiation of existing contracts within the atypical antipsychotic category of drugs, which make up approximately 30 percent of annual drug costs. In addition, General Services entered into two pharmaceutical contracts using its strategic sourcing methodology that should result in significant savings to the State. Namely, General Services implemented a contract with a new prime vendor responsible for distributing drugs purchased under the State's drug procurement program that it estimates will save the State \$1.3 million annually. General Services also contracted with a PBM for the Department of Corrections and Rehabilitation to use to provide prescription drugs to parolees that General Services estimates will save the State an additional \$3.8 million annually. However, General Services reports that its recent efforts to contract with manufacturers of gastrointestinal and anticonvulsant classes of drugs were not successful in delivering cost savings contracts.

Finding #4: General Services was not able to demonstrate that it fully analyzed how to improve its procurement process.

General Services was unable to provide documentation demonstrating that it addressed another recommendation in our January 2002 report: that it fully analyze measures to improve its procurement process, such as joining the Minnesota Multistate Contracting Alliance for Pharmacy (MMCAP) or contracting directly with a group-purchasing organization. General Services does contract with the alliance, but that contract covers only 16 percent of the drug purchases state departments made. With state departments purchasing almost half their prescription drugs at the prime vendor's price, General Services stands to reap benefits for the State by figuring out additional ways to procure prescription drugs.

General Services recognizes that it can do more to ensure that its strategies result in the lowest possible cost to the State. In September 2004, General Services hired a contractor to analyze state spending and identify opportunities to generate savings. General Services stated that, as resources become available, it intends to solicit bids to contract directly with a group-purchasing organization to determine if additional savings can be realized beyond the savings generated by the alliance.

We recommended that General Services follow through on its plan to solicit bids to contract directly with a group-purchasing organization to determine if additional savings can be realized. However, in doing so it should thoroughly analyze its ability to secure broader coverage of the drugs state departments purchase by joining MMCAP. The analysis should include the availability of current noncontract drugs from each organization being considered and the savings that could result from spending less administrative time trying to secure additional contracts directly with drug manufacturers.

General Services' Action: Partial corrective action taken.

General Services determined that an alternative method of accessing a group-purchasing organization should be assessed. It reports that this assessment will include an analysis of the benefits of joining the cooperative purchasing arrangement used by MMCAP. As part of this process, General Services is working with the alliance to identify ways of increasing value from a group-purchasing organization through enhanced reporting and formulary management activities. General Services is also working with the University of California and CalPERS to develop strategies and methods for using a group-purchasing organization. Finally, General Services plans to send a request for information to large and medium size group-purchasing organizations by early January 2007 to gather information to assist it in evaluating the pricing and services available through the alliance. If the information received indicates that additional savings or service benefits can be realized, General Services will promptly prepare and issue a request for proposals for a new method of accessing a group-purchasing organization.

Finding #5: General Services has not fully considered how to identify and mitigate obstacles to enforcing its statewide formulary.

In our January 2002 report, the bureau recommended that General Services fully consider and try to mitigate all obstacles that could prevent the successful development of a statewide formulary, such as departments not strictly enforcing such a formulary at their institutions. A drug formulary is a list of drugs and other information representing the clinical judgment of physicians, pharmacists, and other experts in the diagnosis and treatment of specific conditions. A main purpose of a formulary is to create competition among manufacturers of similar drugs when the clinical uses are roughly equal. However, the success of a statewide formulary and the State's ability to create enough competition to negotiate lower drug prices for certain products depends on how well state departments adhere to the formulary when they prescribe drugs. Although General Services has developed a statewide formulary, it has not identified the obstacles to enforcing it. General Services has not required departments to adopt a policy requiring strict adherence to the statewide formulary and does not monitor departments' adherence to the formulary. General Services does not believe its role is to enforce the formulary, but the goals of a statewide formulary in reducing drug costs cannot be realized without such enforcement.

We recommended that General Services facilitate the Common Drug Formulary Committee and Pharmacy Advisory Board's development of guidelines, policies, and procedures relating to the departments' adherence to the statewide formulary and ensure that departments formalize their plans for compliance.

General Services' Action: Corrective action taken.

General Services reports that at the Common Drug Formulary Committee's October 2005 meeting, and the Pharmacy Advisory Board's January 2006 meeting the formulary was approved. In addition, the departments of Corrections and Rehabilitation, Mental Health, and Developmental Services have provided General Services with implementation plans for the statewide formulary. Now that the statewide formulary has been implemented, General Services and the committee will begin to focus additional resources on the administrative and enforcement concerns raised in our report.

Finding #6: General Services does not have information concerning non-prime vendor drug purchases made by departments required to participate in its bulk purchasing program.

Although state law requires specific state departments to purchase drugs through General Services, our survey of various departments indicates they are not always doing so. Specifically, California Government Code requires the departments of Corrections and Rehabilitation, Developmental Services, Youth Authority, and Mental Health to participate in General Services' bulk purchasing program. In addition, California Public Contract Code requires that all state departments purchasing drugs totaling more than \$100 must purchase them through General Services. California State University, the University of California, and some entities within the California Department of Veterans' Affairs are exempt from this requirement. Although we found that departments generally purchase most drugs through General Services' contract with its prime vendor, they also purchase drugs through other vendors.

Nine state entities purchased prescription drugs using General Services' prime vendor, but each of these entities also purchased drugs from non-prime vendor sources during fiscal year 2003–04. For example, although the Youth Authority purchased drugs from the prime vendor costing roughly \$1.8 million, it also purchased drugs costing almost \$451,000 through other vendors. Seven of the nine entities we surveyed purchased 20 percent to 100 percent of their drugs through non-prime vendor sources. General Services stated that it did not have insight into the amounts and kinds of drugs that entities were purchasing through other sources and therefore has not analyzed these purchases.

In order to make more informed decisions concerning the operation of its prescription drugs bulk-purchasing program and to be able to expand the program to include those prescription drugs that best serve the needs of state departments, we recommended that General Services ask those departments that are otherwise required to participate in the bulk purchasing program to notify General Services of the volume, type, and price of prescription drugs they purchase outside of the bulk purchasing program.

General Services' Action: Corrective action taken.

General Services reports that it now requires those departments that must participate in the bulk-purchasing program to provide it with quarterly reports on drugs purchased outside of the program. This information will aid General Services' pharmaceutical and acquisitions staff in making decisions about the bulk-purchasing program.

Finding #7: Health Services needs to improve the accuracy of its pharmacy reimbursement claim data.

Our review found that Health Services sometimes uses incorrect information when paying pharmacies. In several instances Health Services' payments to pharmacies were based on outdated or incorrect information. Health Services receives updates from a pricing clearinghouse and changes its prices monthly. One factor that Health Services uses to determine the appropriate drug price for a claim is the date of service. Specifically, Health Services uses this date to query its pricing file and identify the price in effect during the date of service on the claim. However, Health Services holds the price updates it receives from its primary reference source until the subsequent month because its budgetary authority only allows for monthly updates. Additionally, Health Services did not update its prices to reflect the elimination of the direct pricing method, which was the price listed by Health Services' primary or secondary reference source or the principal labeler's catalog for 11 specified pharmaceutical companies. Despite state law eliminating this method as of December 1, 2002, Health Services continued to use it during fiscal year 2003–04 to reimburse pharmacies. Health Services stated that the system change error related to the direct pricing method occurred prior to the July 2003 implementation of its fiscal intermediary's Integrated Testing Unit, which is responsible for performing comprehensive tests of system changes to prevent program errors. Health Services also incorrectly calculated drug prices. Although Health Services began corrective action after we brought the issues to its attention, its analyses to quantify the full extent and dollar impact of these errors was not complete as of April 2005.

To ensure that it reimburses pharmacies the appropriate amounts for prescription drug claims, we recommended that Health Services analyze the cost-effectiveness of increasing the frequency of its pricing updates. If this analysis shows that it would be cost-effective to conduct more frequent updates, Health Services should seek budgetary authority to do so. Health Services should also identify prescription drug claims paid using the direct pricing method, determine the appropriate price for these claims, and make the necessary corrections. In addition, we recommended that Health Services ensure that the fiscal intermediary's Integrated Testing Unit removes future outdated pricing methods promptly. Finally, Health Services should ensure that its fiscal intermediary's Integrated Testing Unit verifies that, in the future, drug prices in the pricing file are calculated correctly before authorizing their use for processing claims.

Health Services' Action: Partial corrective action taken.

Health Services reports that a 2005 budget health trailer bill amended the Welfare and Institutions Code to increase the frequency of drug price updates to weekly instead of monthly. Health Services began processing weekly updates in January 2006. In addition, Health Services determined that using the direct pricing method, which was eliminated by state law effective December 1, 2002, caused it to overpay 457,368 claims for a total of \$2.9 million, and to underpay 199,380 claims by more than \$450,000. Therefore, Health Services reports that its total net recoupment will be approximately \$2.5 million for the period of December 1, 2002, through June 30, 2005. Health Services stated that its assessment of the provider impact and corrections to the pricing file must be implemented before it can move forward on this recoupment. As of early-December 2006, Health Services

was working with its fiscal intermediary to complete the corrections. Finally, Health Services has implemented safeguards within the fiscal intermediary's Integrated Testing Unit to assure that these types of errors in the pricing file will not occur on future system changes.

DEPARTMENT OF PARKS AND RECREATION

It Needs to Improve Its Monitoring of Local Grants and Better Justify Its Administrative Charges

REPORT NUMBER 2004-138, APRIL 2005

Audit Highlights . . .

Our review of the Department of Parks and Recreation's (Parks) administration of local grants revealed the following:

- Parks principally relies on certifications by recipients that they complied with grant requirements and expended grant funds for allowable purposes.*
 - Parks has not consistently followed its procedures for monitoring recipients' progress on projects, and such monitoring is inconsistently documented.*
 - Parks could not always demonstrate that specific project objectives for grants were met.*
 - The expected results from the use of General Fund grants are at times not specifically defined in legislation and are subject to Parks' interpretation.*
 - Parks does not separately track its actual costs of administering local grants, creating the risk that bond funds have subsidized the cost of administering General Fund grants.*
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Department of Parks and Recreation's response as of April 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review Department of Parks and Recreation's (Parks) process for administering local grants. Specifically, the audit committee asked us to assess whether Parks' oversight activities ensure that recipients are fulfilling the terms of their grants and spending the funds only on allowable purposes. The audit committee also asked us to determine how Parks defines administrative activities and related expenses, identifying the amounts charged to bond and other funds for administrative expenses.

Finding #1: The Office of Grants and Local Services (grants office) could strengthen its ongoing monitoring of recipients.

The grants office has not consistently followed its procedures for monitoring recipients' progress on projects. As a result, it has not been in a strong position to identify recipients who are not complying with grant requirements. According to its database, the grants office has disbursed \$215 million as advance payments between July 1996 and mid-October 2004. Given the significant amount of funds advanced and the fact that recipients are allowed as much as five or eight years to complete their projects, we expected the grants office to periodically assess recipients' compliance with grant requirements.

The grants office indicated that its project officers have historically conducted annual agency reviews, generally over the telephone, to obtain updates on recipients' progress. However, our review of project files found that annual agency reviews were mentioned in only seven of 14 instances. Further, for these seven, it was generally unclear exactly what information project officers gathered from the recipients during the reviews. In some instances the files gave no indication of the information obtained or the specific projects discussed.

Parks asserted that, in addition to annual agency reviews, project officers maintain continual contact with recipients, obtaining up-to-date information on the status of projects. However, our review revealed a lack of consistent interaction. For 12 of 18 projects, the files indicated that the grants office went more than 10 months without discussing the status of projects with recipients. For two of the 12 projects, the grants office went longer than two years without obtaining updates. Recognizing its need for improvement, the grants office in December 2004 implemented a new policy requiring recipients to report the status of their projects every six months. However this new requirement is essentially nothing more than another self-certification by grant recipients.

Parks should continue its efforts to more consistently monitor recipients' use of grant funds, including its efforts to implement the new six-month reporting requirement. Additionally, Parks should require recipients to submit evidence of project progress and inform Parks about significant project developments. Finally, Parks should revise its policies to ensure that project officers consistently document their interaction with recipients, providing sufficient detail regarding projects for effective future monitoring.

Parks' Action: Corrective action taken.

Parks indicated that it requires grant recipients to submit a Progress Status Report twice a year for all active projects. Parks' revised policy requires that it stop payment on projects where this report is past due for more than 15 days. Along with each report, grant recipients will submit photos of work in progress, report on project status, and report on significant project developments and potential obstacles to project completion. Further, recipients sign under penalty of perjury that the information provided in the report is accurate. Finally, Parks states that it continues to contact all recipients that currently have active grant contracts via telephone to conduct annual agency reviews.

Finding #2: The grants office cannot always demonstrate that the public benefited from its local grants as intended.

Because it uses a monitoring process that relies heavily on recipients self-certifying their appropriate use of grant funds, it is important that the grants office conduct thorough final inspections of projects to ensure that the public benefited as intended from the grants. However, our review of project files revealed that the project officers could not always demonstrate that they performed final inspections or that they ensured specific project objectives were met during inspections they did perform. The grants office indicated that it has waived its requirements for final inspections under unusual circumstances, such as small grant amounts and when photographs are available to document the work. However, Parks has not developed procedures outlining when it will waive this requirement, potentially resulting in an inconsistent approach.

Such inconsistency was noted for one \$500,000 grant where the grants office waived the final inspection requirement, accepting photographs instead. Given the significant amount of the grant, it would have been prudent to visit the site to ensure that the facilities mentioned in the contract were built as planned. For two other projects of 23 we reviewed, the grants office contended that the projects were visited but a final inspection not documented, including one grant for \$985,000. Further, we noted that when final inspections were documented, project officers could not always demonstrate that specific project objectives were met before considering the projects

complete. By not documenting that a final inspection was performed, or not documenting that specific objectives were met, the grants office is less able to demonstrate that the public benefited as intended from the grant.

Parks should develop procedures describing the circumstances under which the grants office will conduct final inspections, ensuring that all recipients who expend significant grant funds are consistently reviewed. Additionally, it should continue with its efforts to better document its final inspections, ensuring that it demonstrates that specific project objectives were met.

Parks' Action: Corrective action taken.

Parks has revised its policies regarding final inspections. Specifically, Parks' new policy requires its staff to document, among other things, that project scope items are complete and that the facilities are open to the public. Further, Parks has established policies regarding when final payments on projects can be made before a final inspection has occurred. Parks will permit final payment of a project before a final inspection when certain conditions are met, such as when the dollar amount of the grant is relatively small or when circumstances exist which make timely inspection impractical. Parks' policy states that when a final payment has occurred without a final inspection, a final inspection should nonetheless be conducted as soon as practical. Parks indicated that it is conducting final inspections on all construction projects and verifying documents to confirm work was completed on all other projects. Parks states that final inspection reports and photos are being filed in the project file and in its computer system as appropriate.

Finding #3: The expected results from the use of General Fund grants are not always clear.

Between July 1996 and mid-October 2004, the grants office disbursed more than \$106 million in local grants from the General Fund. However, sometimes the intended uses of these grant funds are not specifically defined. In fact, in our review of the fiscal year 2000–01 budget act, we noted many instances of the Legislature appropriating General Fund grants with only the recipients' names, grant amounts, and project names specified; the budget act provided no information on what was to be accomplished with the funds. The grants office states that in the absence of clear guidance, it works with the recipient to clarify the project scope. However, the lack of specific legislative direction on the intended use of funds could allow the recipient to potentially submit multiple scope change requests, and the grants office may have little authority to deny the requests.

Sometimes when working with a recipient to identify a project's scope, the grants office interprets what is to be accomplished by the award. For example, the budget act might specify that the purpose of a General Fund grant is to complete construction of a new facility. However, Parks maintains that the legislative intent behind such a grant may not be as clear as it initially appears, questioning whether the Legislature intended the grant to result in a completed facility that would be open to the public or simply to help pay for construction. In such cases the grants office makes decisions as to when it considers a recipient has met its project objectives. However, the grants office does not always clearly establish at the beginning of the grant what the scope of the project is to be and what type of deliverable it expects to see before it makes final payment. Parks indicated that in the future, it will stop action on any General Fund grant when direction is less than perfectly clear in sponsoring legislation. It will ask for further statutory direction from the Legislature before moving forward on the grant.

Should it choose to appropriate General Fund grants in the future, the Legislature should specifically define what is to be accomplished with the funds. In cases where Parks is unclear as to the expected results or deliverables from grant funds appropriated by the Legislature, Parks should continue with its new policy of stopping action on these grants and seeking further statutory language clarifying the intended use of these funds. Finally, to ensure that it is in a stronger position to hold recipients accountable, Parks should clearly document its expectations as to what is to be accomplished with these funds in its grant contracts.

Legislative Action: None.

It appears that the Legislature did not appropriate any General Fund grants to Parks within the Budget Act of 2005. Thus, no legislative action is needed.

Parks' Action: Corrective action taken.

Parks has revised its policies regarding how its grant contracts will document Parks' expectations as to what is to be accomplished with grant funds. Specifically, Parks' new policy requires project scope language in grant contracts to be "sufficiently specific so that the product to be provided by the project is clearly defined." Further, Parks' new policy requires recipients to submit project scope change requests that include a new cost estimate, application, and evidence that the revised project still complies with the law or budget language that established the grant. Further, Parks asserts that it has provided training to its staff regarding its new policies. Finally, Parks provided evidence that it has sought legislative approval for project scope changes for three grants, indicating that it will seek legislative guidance on the intended use of grant funds. Parks indicates that it will advise grant recipients, along with Senate and Assembly members representing the area, whenever there is a question as to the project's scope or applicant.

Finding #4: Parks does not track its actual costs for the grants office's administration of Propositions 12 and 40 programs.

Although Propositions 12 and 40 require Parks to charge only its actual costs of administering each bond's programs to the respective bond fund, Parks does not track its actual administrative costs incurred by the grants office relative to each of the bonds. We focused on the grants office's costs because it is the office that has primary responsibility for monitoring local grants. In general, the actual cost of the grants office is initially charged to a single program cost account, which is funded by Propositions 12 and 40 as well as other funding sources. Although the amounts charged to the account reflect the total cost of the grants office, the costs cannot be directly attributed to Propositions 12, 40, or other funding sources. They typically reflect the total personnel and operating costs of the grants office. Similarly, the sources and amounts funding the single program cost account are not based on the actual work of project officers on programs funded by those sources. The amounts are appropriated by the Legislature based on Parks' administrative cost plan, as modified by statutorily authorized adjustments. Once the program cost account is funded, actual administrative costs are charged to each funding source based on its share of the total funding received by the grants office.

We question whether Parks' methodology for charging the cost of the grants office to bond funds based on the share of funding the grants office receives is valid. Parks' methodology, in effect, allocates more costs to the administration of large grants than that of small grants. However, according to a grants office manager, grant procedures are the same for administering large grants

as they are for small grants, and the level of effort necessary to administer a grant does not depend on a dollar amount as much as it does on other variables, such as the experience and knowledge of the recipient and complexity of the project. Further, for federal funds, Parks is required to periodically assess the reasonableness of its cost allocation methodology to actual costs incurred. Following a similar approach for Propositions 12 and 40 funds would be a prudent practice.

To ensure that it is reasonably charging administrative costs to the appropriate funding sources, Parks should perform quarterly comparisons of its actual administrative costs to the costs it recorded and adjust its methodology and recorded costs as necessary.

Parks' Action: Partial corrective action taken.

Parks indicates that it has completed three separate week-long time reviews where all grants office staff tracked the time they spent on activities. According to Parks, the time reviews illustrated significant fluctuations between sample weeks and were not predictive of the future. As a result, Parks believes that charging its costs to grant funds based on a time study methodology is unworkable. Parks indicates that it is currently in discussions with the Department of Finance to develop a new methodology based on project counts and program characteristics that would equitably distribute program costs.

STATE BAR OF CALIFORNIA

It Should Continue Strengthening Its Monitoring of Disciplinary Case Processing and Assess the Financial Benefits of Its New Collection Enforcement Authority

REPORT NUMBER 2005-030, APRIL 2005

Audit Highlights . . .

Our review revealed that the State Bar of California:

- Continued to monitor its backlog of disciplinary cases and reported 402 cases in the backlog at the end of 2004.*
 - Continued to conduct semiannual reviews of disciplinary case files; however, it noted deficiencies similar to those found in its 2002 reviews.*
 - Developed a checklist for case files and adopted a policy to spot check active cases as we recommended, but the checklist is not comprehensive and staff have not consistently performed the spot checks.*
 - Obtained additional legal authority to collect money related to disciplinary cases, but needs approval of administrative procedures before it can implement the new authority.*
 - Is pursuing an increase in revenues from membership fees to help reduce projected deficits.*
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State Bar of California's response as of April 2006

As required by Chapter 342, Statutes of 1999, the Bureau of State Audits conducted a performance audit of the State Bar of California's (State Bar) operations covering January 1, 2004, through December 31, 2004. In planning this audit, we followed up on three principal areas identified during our 2003 audit: the State Bar's processing of disciplinary cases, cost recovery as part of processing disciplinary cases, and the use of mandatory and discretionary funds to support State Bar functions.

Our report concluded that the State Bar continued to monitor its backlog of disciplinary cases that resulted from its virtual shutdown in 1998. In addition, the State Bar's semiannual reviews of randomly chosen disciplinary cases in 2004 disclosed deficiencies similar to those found in its 2002 random reviews. To address these deficiencies and in response to our 2003 audit recommendations, the State Bar developed a brief checklist to guide staff in processing disciplinary cases. However, its staff did not always use the checklist and it is not sufficiently comprehensive. The State Bar also adopted a policy to spot check open disciplinary cases to ensure that staff are maintaining files properly and handling complaints correctly. However, we found that staff did not consistently perform the requisite number of spot checks and sometimes failed to document the results.

Further, the State Bar's recoveries of disciplinary costs and Client Security Fund payments remained low. Therefore, to subsidize these costs, it used a larger portion of the membership fees it collected than it would have if its recovery rates were higher. Although a law effective in January 2004 improved its ability to recover past and future costs, the State Bar has not yet been able to use this new authority because it is waiting for approval of certain administrative procedures by the California Supreme Court. Finally, the State Bar is pursuing a revenue increase to help reduce projected deficits in its general fund and Client Security Fund. Specifically, we found:

Finding #1: The State Bar continued to monitor its case backlog while seeing little change in the number of disciplinary cases it processed.

The State Bar processed almost the same number of cases through its intake and enforcement units in 2004 as it did in 2002. In addition, although it reported that its backlog of disciplinary cases increased to 540 cases in 2003, the backlog it reported at the end of 2004 was 402 cases, which is almost identical to the backlog at the end of 2002. Even though the State Bar maintains an “aspirational goal” of reducing the backlog to 250 cases, it believes that having a backlog of about 400 cases may reflect the norm.

We recommended that the State Bar continue its efforts to control its backlog of disciplinary cases.

State Bar’s Action: Corrective action taken.

The State Bar reported that it has reorganized the Office of the Chief Trial Counsel, in part, to address structural and reporting issues that have historically contributed to the creation of the backlog. In particular, it eliminated the separate trial unit and investigation unit and created four trial and investigation units that it believes will result in greater teamwork in performing adequate investigations and preparing cases for trial. The State Bar also stated that, since September 1, 2005, its deputy trial counsel, rather than investigators, oversees all disciplinary investigations. By December 2005, the State Bar reported a reduced backlog of 315 cases, the lowest year-end backlog level since 1997 when the backlog was at 253 cases. By continuing to focus on the disposition of existing backlog cases and avoiding the roll-in of new cases into the backlog, it is the goal of the Chief Trial Counsel to further reduce the backlog to about 200 cases by the end of 2006.

Finding #2: The State Bar needs to fully implement its procedures and policies for monitoring disciplinary case processing.

The State Bar’s random reviews of its disciplinary case files indicate that staff still have not consistently followed policies and procedures when processing complaints filed against its members. In particular, in its 2004 semiannual reviews of randomly chosen case files, the State Bar identified some of the same deficiencies as it identified in 2002 reviews. To address some of these issues, and in response to the recommendations we made in our 2003 report, the State Bar developed a checklist to ensure that staff complete important steps in processing complaints and include all necessary documents in every case file. Further, in 2004 the State Bar instituted a policy requiring team leaders to periodically spot check active files. However, we found that staff have not consistently used the checklist and it is not sufficiently detailed. In addition, we found little evidence of compliance with the spot-check policy.

We recommended that the State Bar:

- Establish a written policy requiring staff to maintain a checklist of the important steps involved in processing disciplinary cases and include all necessary documents in every case file, rather than relying on an informal instruction that the checklist be used.
- Develop a checklist that is more comprehensive than the current investigation file reminder, such as the tool that the audit and review unit uses when it randomly reviews disciplinary case files.

- Make supervisors responsible for ensuring that each case file includes a checklist and that staff use it.
- Enforce its policy of spot checking the files of active disciplinary cases and require team leaders to document the results of their spot checks.

State Bar's Action: Corrective action taken.

The State Bar reported that it has developed a more comprehensive checklist and directed its staff to begin using the checklist effective July 1, 2005. In addition, the State Bar stated that it has issued a policy directive that addresses the monthly random audits of open investigation files, as well as the requirement to document the results of the random audits using a checklist form developed for that purpose.

Finding #3: Changes in state law may improve the State Bar's recovery of disciplinary costs and Client Security Fund payments.

The State Bar's cost recovery rates in 2004 were comparable to its recovery rates in 2002; however, they remained low compared with the total amounts billed. Specifically, the State Bar's cost recovery rates in 2004 for discipline and the Client Security Fund were 40.5 percent and 10.7 percent, respectively. Therefore, the State Bar used a larger portion of its membership fees to subsidize its disciplinary activities and the Client Security Fund than it would have with a higher recovery rate. In the past, the State Bar had little success in recovering costs from disbarred attorneys or attorneys who resigned, in part, because it lacked specific authority to pursue recovery of debts under the Enforcement of Judgments Law. However, based on amendments to the Business and Professions Code, effective in January 2004, the State Bar now has the requisite legal authority, which may improve its ability to recover not only future costs but also some portion of the \$64 million in billed costs that remain unrecovered since 1990.

To enable it to carry out the statute, the State Bar has proposed to the California Supreme Court that the California Rules of Court be amended. The proposed amendments, which the State Bar submitted to the supreme court in February 2005, would require the superior court clerk of the relevant county to immediately enter a judgment against an attorney for the amount the State Bar certifies the attorney owes for disciplinary costs or Client Security Fund payments. After obtaining the money judgment, the State Bar would be able to garnish wages or obtain judgment liens on real property the attorney owns. Until the Supreme Court approves the proposed procedures, the State Bar cannot exercise the money judgment authority.

We recommended that the State Bar prioritize its cost recovery efforts to focus on attorneys who owe substantial amounts related to disciplinary costs and payments from the Client Security Fund.

State Bar's Action: Partial corrective action taken.

The State Bar reported that it is still awaiting the Supreme Court's approval of the proposed rule of court for the procedures needed to begin filing of money judgments. In March 2006, the Clerk of the Supreme Court requested the State Bar to make certain nonsubstantive changes to the proposed rule of court and to resubmit its proposal. The State Bar's executive director expected approval of the changes by the board of governors in May 2006. The State Bar

also indicated that it continues to monitor the responses from disciplined attorneys to the demand letters that have been mailed in its two pilot projects—one targeting the most recently disciplined attorneys and another targeting the 100 disciplined attorneys who owe the most in disciplinary costs. As of April 2006, the State Bar reported that collections as a result of the first and second pilot projects have totaled \$48,112 and \$24,411, respectively. Further, the State Bar indicated that in each matter that remains unpaid, it continues retrieving relevant documents from the files of disciplined attorneys so that it can file requests for money judgments when the proposed rule is adopted.

The State Bar also indicated that it has attained a favorable ruling in the lawsuit that one disbarred attorney who received a demand letter for repayment of disciplinary costs had filed in federal court challenging the constitutionality of the amendments permitting the State Bar to enforce disciplinary costs as money judgments. However, the attorney has appealed and the matter is now pending in the Ninth Circuit.

Finally, the State Bar reported that it has completed its review of attorneys with court-ordered restitution from the list of the 100 attorneys owing the most in Client Security Fund reimbursements and reconciled the amounts these members owe. It found that Client Security Fund restitution was ordered only in one matter. Therefore, the State Bar believes that the benefit of the new collection enforcement authority will be largely prospective.

Finding #4: The State Bar is pursuing a revenue increase to help reduce projected deficits.

Based on the State Bar's financial forecast, the combined balance of its general fund, which accounts for activities related to the disciplinary system, and its Public Protection Reserve Fund, which was established to ensure the continuity of the disciplinary system, will sink into a deficit of \$13.8 million by the end of 2008 unless revenues from membership fees increase.

The forecast assumes a significant increase in staff salaries and wages beginning in 2006 and no change in membership fees. For its general fund the State Bar predicts that expenses will exceed revenues starting in 2005, which will eventually use up the surplus in the general fund. The State Bar also predicts that its Client Security Fund, which it uses to help alleviate the financial losses suffered by clients of dishonest attorneys, will have a deficit by the end of 2006. To avoid projected deficits, the State Bar has proposed a bill that would increase its membership fees by \$5 for active members and \$95 for inactive members and would change the criteria for active members to qualify for a partial fee waiver. If approved, these changes would become effective on January 1, 2006.

We recommended that the State Bar continue to update its forecasts for key revenues and expenses as new information becomes available. For example, the State Bar should closely monitor the results of its enhanced collection enforcement authority and the benefits it may have on recovery of disciplinary costs and Client Security Fund payments.

State Bar's Action: Partial corrective action taken.

The State Bar reported that its fee bill for 2006 and 2007 was signed into law in September 2005. The authorized fees are slightly different than those discussed in the audit report. The State Bar indicated that its recently updated financial forecast for the general fund that includes 2005 actual operating results projects a modest surplus of \$266,000 at the end of 2007. In addition, the State Bar indicated that it will continue to monitor key 2006 revenues and expenses on a quarterly basis, including monies collected through cost collection efforts, and will update its financial forecast accordingly.

DEPARTMENT OF FINANCE

Investigations of Improper Activities by State Employees, July 2004 Through December 2004

INVESTIGATION I2004-1104 (REPORT I2005-1), MARCH 2005

Department of Finance's response as of March 2006

Investigative Highlight . . .

The Department of Finance improperly divulged confidential information.

We investigated and substantiated an allegation that the Department of Finance (Finance) improperly disclosed confidential information.

Finding: Finance improperly disclosed confidential information.

In violation of privacy rights, Finance published the name and Social Security number of a former state employee in a publication that is distributed throughout the State and is available on the World Wide Web. In addition, Finance identified two other state employees and a state vendor whose names and Social Security numbers had also been improperly disclosed.

Finance's Action: Corrective action taken.

Finance removed the confidential information from its Web site and from any Web search engines that may have archived information from its Web site prior to being updated. In addition, Finance provided hard copy updates, without the confidential information, to users of the publication and revised its procedures to prevent violations of this nature in the future. Finally, Finance took steps to notify those individuals of the improper disclosure.

THE STATE'S OFFSHORE CONTRACTING

Uncertainty Exists About Its Prevalence and Effects

Audit Highlights . . .

Our review of the extent of the State's offshore contracting revealed the following:

- No current state laws or regulations address the use of offshore contracting, making it difficult to judge the prevalence and effects of offshore contracting.***
- Our analysis of the limited survey data suggests the State is spending little on services performed offshore:***
 - ***Thirty-nine entities responding to our survey reported 185 contracts totaling \$689.9 million where at least some portion of the work was possibly performed offshore.***
 - ***For 109 of these contracts totalling \$349 million, respondents estimated that only \$9.7 million (2.8 percent) was for services performed offshore but could not provide an estimate for the remaining 76 contracts.***
- The offshore contracts we reviewed generally contain provisions to protect sensitive and confidential information from disclosure.***

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REPORT NUMBER 2004-115, JANUARY 2005

The Joint Legislative Audit Committee (audit committee) directed us to examine the extent to which state-funded work is being contracted or subcontracted out of the country. Specifically, the audit committee asked us to review any Department of General Services' (General Services) policies and procedures relevant to offshore contracting (offshoring) and directed us to survey selected state agencies to identify those that have, or are most likely to have, contracted for services offshore during the previous three fiscal years. Further, for a sample of those agencies identified as having contracts for services offshore, the audit committee asked us to review and evaluate the agencies' policies and procedures for offshoring, including how the agency protects against the disclosure of sensitive and confidential information.

Finding #1: State agencies receive no guidance on offshore contracting.

State agencies currently receive no guidance related to offshoring and are not required to track where their contracted services are being performed or report the extent to which services are being performed offshore. As the State's contracting and procurement oversight agency, General Services oversees state purchasing, approves contracts for services, and sets contracting policies for the State. According to General Services, neither the State Contracting Manual nor any current state law or regulation specifically addresses the use of offshore contracting, the practice of subcontracting portions of a contract offshore, or the issue of determining where contracted services are performed. This lack of guidance can result in inconsistency in contract provisions among state agencies and makes it difficult to judge the effects and prevalence of offshoring.

We recommended to the Legislature that if it desires information and data on offshore contracting of state services to be more readily available, it may consider granting General Services the authority to require contractors to disclose, as part of their bid on state work or during performance of the contract, details on any and all portions of the project that subcontractors or employees outside the United States will perform.

- ☑ *Proposed legislation designed to place restrictions on and limit offshore contracting could face legal challenges or have unintended consequences.*
-

Legislative Action: Legislation vetoed.

During the 2005–06 session, the Legislature passed Assembly Bill 524 that would have required all successful bidders on state services’ contracts to complete a questionnaire and report on the portions of the contract that would be performed by subcontractors or employees outside of the United States. The governor vetoed the bill on September 29, 2005.

Finding #2: The extent of state entities’ offshore contracting remains unclear.

Our survey of selected state agencies and campuses (entities) gives a limited understanding of the extent of these entities’ offshore contracts because, as mentioned earlier, state agencies are not currently required to collect or track data on state-funded services being performed offshore. Because of the difficulty in identifying where subcontracted work is performed, capturing with any certainty the amount of state funds spent on services performed offshore is a challenge. However, from our limited data, the State apparently has been spending little on services performed in foreign countries.

Specifically, we surveyed the 35 state agencies with the largest dollar amount of contracts for certain services and the five University of California campuses with medical centers about their use of offshoring. These entities reported 185 contracts totaling \$638.9 million in which at least some portion of the work has possibly been performed offshore. Asked to estimate the dollar amount of these offshored services, entities reported that they did not know the amount for 76 of these contracts. For the remaining 109 contracts, totaling \$349 million, entities estimated that only \$9.7 million (2.8 percent) of the contracted services were performed offshore.

Finding #3: Previous efforts to determine the prevalence of offshoring also yielded limited results.

Three other organizations that tried to determine the prevalence of services contracted offshore also produced limited results. Specifically, General Services, in response to a February 2004 legislative directive, provided documentation detailing all the internal contracts it entered into that had work performed out of state or out of the country. General Services found that when contractors’ specified work was performed offshore, the degree of offshore work was not always apparent. According to General Services, such data is extremely difficult to gather because the State currently has no requirement for state agencies to collect and track any offshore information. Additionally, a nonprofit corporate research company claims that most states cannot estimate the total amount or value of state contract offshoring because most state governments do not know where service work they contract

out is performed. Finally, the U.S. Government Accountability Office concluded that although there are anecdotal accounts of state governments using offshore contracts, no comprehensive data or studies of the extent to which state governments use these contracts are available.

Finding #4: Contract provisions related to subcontracting are not consistent among entities.

Our survey results show that state entities are inconsistent about including contract provisions related to subcontracting, delegating, or assigning contract duties. Specifically, we asked survey participants if their general contract provisions prohibit any or all of the contracted services to be subcontracted, assigned, or delegated. Eleven of the 39 entities responding reported that they generally prohibit any or all services from being subcontracted, assigned, or delegated. Another 24 responded that their contract provisions generally do allow for services to be subcontracted, and the remaining four entities did not respond to the question. Of the 24 entities that generally allow for subcontracting, four reported that their contracts generally do not require the contractor to notify the agency when subcontracting services. However, when entities do not require such notification, they are unaware of who is providing the services, making it difficult to effectively manage the contract.

Finding #5: Offshore contracts generally contain provisions protecting confidential information.

The offshore contracts we reviewed generally contain provisions to protect sensitive and confidential information from disclosure. Current state and federal laws protect an individual's confidential information, such as medical records, from disclosure. Of the 185 contracts that state entities reported as having at least some portion of the work performed offshore, we identified 11 contracts in which the contractor has access to confidential information. All 11 of these contracts contain, at a minimum, general terms that prohibit the contracted parties from disclosing sensitive and confidential information, and some specifically describe the contractor's responsibility in protecting this information. Nine of the 11 contracts allow the State to terminate the contract if the entities consider the contractor to be in material breach of the terms and conditions, including those protecting sensitive and confidential information. Finally, nine of the 11 contracts include a provision dictating that the governing law of the contract shall be the laws of the State.

General Services requires state contracts to include standard terms and conditions that subject the contract to the laws of California, including those related to confidential information, and that impose liability on the contractor for all actions arising out of the contracts. However, it is important that all parties to the contract, including all subcontractors, either domestic or offshore, are aware of these standard terms and conditions and comply with them.

Finding #6: Legislative attempts to restrict offshore contracting raise serious legal concerns.

The federal government and 40 states, including California, have proposed or adopted legislation to restrict offshoring. These include laws that would prohibit all contracts in which work is performed offshore, provides preferences to state or local vendors, require that state contracts detail and report all services performed offshore, and require disclosure if contractors send sensitive or confidential information offshore. Existing research indicates that state efforts to

restrict offshoring may violate constitutional provisions allowing the federal government to set uniform policies for the country as a whole in dealing with foreign nations. Also, restricting or limiting offshoring may invite retaliatory trade sanctions against the United States. Before proposing measures to restrict offshoring, policymakers need to consider whether such actions are both legally sound in the United States and capable of withstanding international legal challenges.

DEPARTMENT OF EDUCATION

Its Mathematics and Reading Professional Development Program Has Trained Fewer Teachers Than Originally Expected

Audit Highlights . . .

Our review of the Mathematics and Reading Professional Development Program (program) revealed that:

- Only a small percentage of mathematics and reading teachers have completed the full 120 hours of training for their current assignments.*
- School districts we surveyed cited several barriers to increased participation in the program, including teacher apathy toward attending training, concerns about funding, and a lack of training providers in close proximity. Nevertheless, school districts in counties with relatively large or small numbers of eligible teachers in various geographic regions throughout the State appear equally capable of accessing program services.*
- The Department of Education (Education) has done little to actively promote the program and currently relies on school districts to navigate its Web site to learn about and apply for the program.*

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REPORT NUMBER 2005-133, NOVEMBER 2006

The Department of Education's and State Board of Education's responses as of November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Mathematics and Reading Professional Development Program (program). Approved in 2001 (Chapter 737, Statutes of 2001), the program provides incentive grants to local education agencies that choose to send their teachers through standards-based instructional training. Under state law, the State Board of Education (board) adopts educational content standards and is responsible for approving the curriculum of providers wishing to train teachers under the program.

The audit committee asked us to review the board's and the Department of Education's (Education) policies and management practices to determine if they are consistent with the legislative intent of the program. Specifically, the audit committee asked us to assess the method used to track teachers' access to and participation in the program and the extent of any outreach efforts. The audit committee also asked us to identify the number of training providers that offer teacher development services and whether the board's approval process allows for a sufficient pool of training providers. Finally, the audit committee asked us to assess whether Education had adequate internal controls to track program expenditures and to identify any organizational, statutory, or regulatory impediments to the program.

Finding #1: Only a small percentage of teachers have completed the program for their current assignments, while limited data at Education and the school districts makes assessing the program's success difficult.

When the Legislature adopted the program in 2001, it envisioned that 176,000 teachers would receive training on the State's academic content standards over a four-year period. This target represented the majority of the 252,000 teachers statewide who were eligible for program-funded training at that time. Our survey of 100 school districts that participated in the program through fiscal year 2004–05, which represented 46 percent of the State's 398,000 eligible teachers as of January 2006, indicates that data exists at school districts to

- ☑ *Education has not ensured that program compliance audits are conducted in accordance with program statutes.*
- ☑ *Education's July 2005 report to the Legislature was of limited value because it lacked relevant and accurate data for gauging program outcomes.*
- ☑ *Education's ability to adequately track teacher participation in mathematics and reading training is complicated by the multiple funding sources involved and by reduced program-specific funding.*
- ☑ *The State Board of Education relied on the Sacramento County Office of Education to advertise and implement the program.*

substantiate that only 7,230 teachers have been fully trained. This amount represents roughly 3 percent of the 240,987 eligible teachers in school districts that had received program funds through fiscal year 2004–05. Further, 41 school districts from our survey, representing 105,764 teachers, could not readily tell us how many had completed the entire 120 hours of training. More than half of these 41 school districts indicated that they did not have enough information to report specifics about the number of teachers that had completed the training. We acknowledge that some of the teachers in these 41 districts may have completed part or all of the program. We also acknowledge that school districts have not likely been asked to provide complete information about the number of their teachers that have completed the program for their current teaching assignments.

Finally, we noted that Education's July 2005 report to the Legislature was of limited value because it lacks relevant and accurate data regarding the number of trained teachers that are currently using the training in the classroom and provides no correlation between teacher training and student achievement. Education's data collection process resulted in duplicated counts of teachers that had received, but not necessarily completed, program training. As a result, decision makers cannot gauge the progress being made toward accomplishing the program's goals and are ill-prepared to make future funding decisions. Education acknowledged that its report has limitations, stating as much in its report to the Legislature.

Given that only a small percentage of teachers have completed the full 120 hours of program training, and that teacher participation is voluntary, the Legislature should consider redefining its expectations for the program, clearly stating the number of teachers to be fully trained as well as any gains in student achievement expected. Based on how it defines the program's goals, the Legislature should consider making statutory changes to ensure that Education provides meaningful data with which to evaluate program success. Examples of meaningful program data include the following:

- Unduplicated counts of teachers who have completed the training with the aid of program and non-program funding, with a comparison of these figures to the total number of teachers who are eligible to participate in the program.
- Measures of the resulting gains in student achievement for teachers who have completed the program's training, such as higher student scores on standardized tests.

Legislative Action: Unknown.

Finding #2: School districts responding to our surveys cited a variety of reasons for low teacher participation rates.

During the audit we conducted two surveys, each comprised of 100 school districts, that either had or had not received program funding through fiscal year 2004–05. School district responses to both surveys indicated that participant districts and nonparticipant districts alike perceived similar barriers to increased teacher participation in the program. The barriers most frequently cited by school districts were teacher apathy towards the training, concerns about funding, and a lack of training providers nearby. The similarities in these results suggest an opportunity for Education and the board to take steps to improve the program.

We received 169 responses to our surveys of 200 school districts. Responses from 51 of the 169 school districts indicated that a lack of teacher interest was a barrier to greater teacher participation. Some districts indicated that their teachers felt the training program was too long or too closely tied to textbooks, as opposed to a broader focus on understanding state standards. In addition, 42 of the 169 school districts cited funding concerns, primarily related to the timeliness of payment or the amount of funding. Some school districts stressed that they must initially pay for program training with their own funds and then seek program payment from Education, which can take many months. We noted that the program’s payment process can be as long as four to six months for any single year’s first payment. Some of this delay is caused by Education’s need to wait for the board to approve annual certifications from school districts before making program payments.

The remaining barrier cited most frequently by school districts was the lack of training providers in close proximity to the school district. In particular, 33 of the 169 survey respondents cited this as a concern. Some respondents stated that rural school districts are placed at a disadvantage in obtaining training for their teachers because they have more difficulty accessing training providers. However, our review of program payments through fiscal year 2005–06 revealed that counties with relatively large and small numbers of eligible teachers in various geographic regions throughout the State appear equally capable of accessing program services.

To remove a barrier to increased teacher participation in the program, Education should explore opportunities to expedite its payment process to school districts. One such opportunity would be to seek legislation authorizing Education to approve the annual certifications submitted by school districts instead of waiting for board approval, thus removing any payment delay caused by the need to wait for the next board meeting.

Education’s Action: Pending.

Education indicated in its response to the audit report that it will explore the possibility of seeking legislation that would authorize it to approve the annual certifications submitted by school districts.

Finding #3: Education does little to encourage districts to participate in the program.

Education’s role in administering the program has essentially been limited to forwarding school districts’ annual application to the board for approval and to processing program payments. Although not specifically required to do so under the program’s statutes, Education has done little to actively promote the program. This lack of ongoing outreach may contribute to the low percentage of school

districts that have participated in the program, and may explain why nine of the districts that responded to our nonparticipant survey indicated that they were unaware of the program's existence or were confused about the eligibility or funding aspects of the program.

To ensure that school districts are aware of the program and that as many teachers participate in the program as possible, Education should conduct annual outreach activities to all school districts. A component of such an outreach program should include directly informing each school district of the amount of funding for which it is eligible each year.

Education's Action: Pending.

In its response to the audit report, Education indicated that it will continue to update its Internet Web site, including program information pages, frequently asked questions, and lists of eligible teachers and training providers. In addition, Education anticipates working with the board to develop an outreach plan. This plan will include annual letters to districts about the program, changes mandated by new legislation, and the available funding for the fiscal year.

Finding #4: Education has not taken the necessary steps to ensure that program compliance audits occur at school districts.

Education has not ensured that program compliance audits are conducted in accordance with program statute. Specifically, Section 99237 of the Education Code requires that annual financial and compliance audits of school districts include steps to ensure that teachers for whose training districts received program funding were, in fact, trained and that the training met program requirements. In addition, this section requires Education to withhold monthly apportionment payments to school districts to the extent that the results of audits reveal noncompliance with these requirements. Given this responsibility, we would have expected Education to take the necessary steps to ensure that these audits are actually taking place. However, discussion with Education staff revealed that such audits have likely never taken place because the compliance requirements have never been included in audit guides.

According to program statute, the compliance audits are to be performed by licensed local auditors, as opposed to Education's audit division, with the assistance of an audit guide specifying state compliance requirements. The Education Code, Section 14502.1, requires the State Controller's Office (controller), in consultation with the Department of Finance, Education, and representatives of specified organizations to propose the content of the audit guide and submit it to the Education Audit Appeals Panel for review, possible amendment, and eventual adoption. To Education's knowledge, the program's compliance requirements have never been included in the audit guide, and a controller representative confirmed that Education never informed that office of the program and its compliance requirements. As a result, Education has disbursed about \$113 million through fiscal year 2005–06 without ensuring the level of oversight required by statute.

To ensure that required compliance audits are occurring, Education should take steps to ensure that the program's compliance requirements are included in audit guides related to the annual audits of school districts.

Education's Action: Pending.

Education asserted in its response to the audit report that it has drafted the necessary program compliance requirements for consideration by the controller and Education Audit Appeals Panel for inclusion in the audit guide.

Finding #5: The board did not obtain approval from the Department of General Services for program-related contracts with two county offices of education.

Our audit noted that the board relied on two county offices of education for various program functions, including the development of criteria for evaluating training providers and the facilitation of the evaluation of curricula submitted by potential training providers. To provide these services, the board, acting through Education, entered into various contracts with the Sacramento County Office of Education and Orange County Department of Education. According to state law, all contracts entered into by state agencies, except those meeting certain exemptions, are not in effect unless and until approved by the Department of General Services. The board did not obtain the required approvals before the beginning of the contract term for all three program-related contracts and related amendments requiring approval. As a result, the board exposed the State to potential liability for work performed before the contract was approved.

To ensure that it does not expose the State to potential liability for work performed before the contract is approved, the board should ensure that it obtains the Department of General Services' approval of its contracts and amendments before the start of the contract period and before contractors begin work.

Education's Action: Corrective action taken.

In its response to the audit report, the board indicated that Education's procedural revisions to its contracting process, which it had implemented since the time of the program-related contracts referenced in the audit report, has had a profound effect on eliminating late contracts. Specifically, Education's Contracts and Purchasing Unit requires staff to submit contract request forms 60 days prior to the start of the contract. The board also cited an administrative order by the Department of General Services, clarifying the general policy on the timely submission of contracts and the circumstances under which contracts can be approved after the start date.

CALIFORNIA PUBLIC SCHOOLS

Compliance With Translation Requirements Is High for Spanish but Significantly Lower for Some Other Languages

Audit Highlights . . .

Our review of the California Department of Education's (department) and California public schools' compliance with California Education Code, Section 48985 (state translation requirements) revealed the following:

- Compliance with the state translation requirements is high for Spanish, but significantly lower for some other languages.*
 - Some schools are unaware of this state law or may use incorrect methods to identify languages that require translations. In addition, some schools believe there is little demand for translated notices.*
 - Although the department has a process that may assist schools in meeting these requirements, recently enacted legislation requires it to take a larger role in ensuring that schools comply with the state translation requirements.*
 - The department created an electronic clearinghouse for multilingual documents, but it has not achieved much participation from school districts.*
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REPORT NUMBER 2005-137, OCTOBER 2006

California Department of Education's response as of January 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether the California Department of Education (department) and California public schools are in compliance with California Education Code, Section 48985 (state translation requirements). This code section requires that when 15 percent or more of students enrolled in a public school speak a single primary language other than English, all materials sent to the parent by the school or school district must be provided in that language as well as in English. Specifically, the audit committee requested that we identify and evaluate the department's role, if any, in informing local education agencies of the state translation requirements and in monitoring and ensuring their compliance with these requirements. The audit committee also asked us, to the extent possible, to determine how pending legislation would affect the department's distribution of information and oversight of local education agencies' compliance with state translation requirements. Finally, the audit committee asked that we select a sample of districts or schools and identify and evaluate measures taken to include parents in their children's education, the process through which schools meet the state translation requirements, and the extent to which schools comply with these requirements. We found that:

Finding #1: Some districts do not perceive a demand for translations and the home language survey may overstate the need for translations.

About half of California's 10,100 public schools had at least one primary language that required translations in fiscal year 2004–05, and we found that compliance for fiscal year 2005–06 was high for Spanish. Specifically, a survey requesting information about certain notices schools send to parents that we sent to 359 schools, to which 292 schools responded, indicated that schools are providing required Spanish translations for 4,136 of 4,534, or 91 percent of the notices for which we received responses, while for 1,134 notices we did not receive a response. However, compliance rates drop significantly for some of the languages other than Spanish. For example, our survey indicates

that schools are providing Mandarin and Hmong translations for only 54 percent and 48 percent, respectively, of the notices for which we received a response. We did not receive responses regarding the translations of 36 and 18 notices in Mandarin and Hmong, respectively. We found a variety of reasons for these lower compliance rates. For example, 16 percent of the survey respondents were not aware of the state translation requirements. In addition, some schools may not be meeting state translation requirements because their districts may use incorrect methods to identify the languages requiring translations.

As indicated by the results of our site visits, some school districts do not comply with state translation requirements because they believe there is little demand for translated notices. For example, San Diego Unified School District (San Diego) asserted that the main reason it stopped translating documents into Tagalog was a lack of requests for Tagalog translations from schools. Furthermore, although Tagalog was the primary language spoken at home by nearly 40 percent of the students enrolled at San Diego's Mary McLeod Bethune Elementary School during fiscal year 2004–05, a survey initiated by the principal in June 2006 resulted in only 5.6 percent of parents requesting that notices be sent home in Tagalog. Similarly, Cupertino Union Elementary School District generally does not provide Mandarin translations, even though this primary language is spoken by at least 15 percent of the students at several of its schools, because it perceives little demand for these translations. Finally, two districts indicated that in addition to low demand, some parents actually resented receiving translated documents. For example, both San Diego and Fountain Valley School District recalled instances in which parents had called the district to complain that they did not want to be sent translated documents in Tagalog and Vietnamese, respectively.

School districts should use a home language survey developed by the department to determine each student's primary language. Specifically, when parents enroll their children in a new school, the school district should administer the home language survey, which contains a series of questions to assist the school district in identifying the primary language spoken at home. However, the home language survey may overstate the need for translations because it does not account for parents who are fluent in English. The survey was designed to identify the primary language that a student speaks at home and to determine whether the district must assess the student's English proficiency using the California English Language Development Test. It was not designed to identify those parents who are bilingual. Consequently, this tool may overstate the need for translations for those parents whose primary language is not English but who are also fluent in English. Nevertheless, it is inappropriate for districts to assume that there are no parents who need documents translated into the languages that meet the 15 percent threshold under state law. Without asking parents whether they require translations, districts and schools have no way of knowing what the actual demand is and therefore cannot justify sending documents home in English only.

To ensure that translated notices are sent only to parents who need them, the department should modify the home language survey to include a question asking parents to indicate the language in which they would like to receive correspondence. To ensure that this modification does not conflict with current law, the department should seek legislation to amend state law to allow parents to waive the requirement that they receive translated materials in their primary language when they do not need such translations.

Department's Action: Partial corrective action taken.

The department reports that its program offices that oversee or provide input to the home language survey are coordinating efforts to modify the survey to include a question asking parents to indicate the language in which they would like to receive correspondence and whether they elect to waive the receipt of translated materials. If deemed necessary, the department will seek legislation to amend state law to modify the requirements pertaining to the home language survey. The department expects to implement this recommendation by May 2007.

Finding #2: Although not extensively utilized, the clearinghouse for multilingual documents could become a useful tool.

Pursuant to state law, the department created an Internet-based electronic clearinghouse for multilingual documents (clearinghouse) on which local education agencies and the department can post links to translated parental notices. The purpose of the clearinghouse is to provide increased access to translated documents, to assist local education agencies in meeting legal requirements for parental notification, and to reduce redundancy in document translation work. Launched in September 2005, the clearinghouse is an online resource designed to help local education agencies locate, access, and share parental notification documents that have been translated into languages other than English. Through the clearinghouse, local education agencies voluntarily provide information regarding translations they have made and are willing to make available to others. The department hosts the clearinghouse on its Web site.

Despite the department's efforts to promote the clearinghouse, it has not achieved much participation from school districts. Specifically, 12 school districts and the department had posted links to translated notices on the clearinghouse as of mid-September 2006. In addition, 80 percent of the 230 translated documents available through the clearinghouse were available only in Spanish as of mid-September 2006. The value of the clearinghouse as a resource cannot truly be achieved without greater participation from school districts.

To increase the value of the clearinghouse as a resource for translated parental notices, the department should encourage school districts to form coalitions for the purpose of leveraging their combined resources to translate standard parental notices into the languages they have in common. In addition, the department should consider using its available funding to encourage districts to upload links to their translated documents, especially in languages that are currently underrepresented in the clearinghouse.

Department's Action: Partial corrective action taken.

The department reports that it plans to send letters to school districts that will include information about forming translation consortia. In addition, the department plans to inform school districts about new reports that contain data by language group that will help them identify other districts with common translation needs. The department will make these new reports available on its Web site. Finally, the department states that it will consider using available clearinghouse funding to encourage school districts to participate in the clearinghouse. As part of this effort, the department will determine whether clearinghouse funds can be spent in this manner in light of existing provisional language contained in the budget act.

UNIVERSITY OF CALIFORNIA

Stricter Oversight and Greater Transparency Are Needed to Improve Its Compensation Practices

REPORT NUMBER 2006-103, MAY 2006

University of California's response as of November 2006

Audit Highlights . . .

Our review of the compensation practices of the University of California (university) revealed the following:

- The Corporate Personnel System (CPS) used by the university's Office of the President (president's office) to track the pay activity of university campuses contains inconsistencies and overly vague categories that did not allow us to determine the reliability of various compensation and funding source classifications contained within it and that limit its usefulness as an oversight tool.*
- Despite these problems, the CPS is the most detailed and complete centrally maintained source of information, and in fiscal year 2004–05 it reflects that university employees earned approximately \$9.3 billion—comprised of \$8.9 billion in regular pay and \$334 million in additional compensation.*
- The president's office appears to regularly grant exceptions to university compensation policy. In a sample of 100 highly paid university employees, 17 benefited from an exception to compensation policy.*

continued on next page . . .

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the compensation practices of the University of California (university) and to identify systemwide compensation by type and funding source. In addition, we were asked to categorize the compensation of highly paid individuals receiving the most funds from state appropriations and student tuition and fees, and to determine whether they receive any additional compensation or employment inducements not appearing in the university's centrally maintained records.

The audit committee also asked us to determine the extent to which university compensation programs are disclosed to the Board of Regents (regents) and to the public, including the types of programs that exist, their size and cost, and the benefits that participants receive. Finally, we were asked to survey other universities about their compensation disclosure practices and the number of participants and expenses for those programs. Our survey found that the University of California's disclosure practices were similar to those of other universities.

Finding #1: Lack of consistency within the Corporate Personnel System (CPS) limits its usefulness.

The personnel information reporting system used by the university, the CPS, contains inconsistencies and overly vague categorizations. For example, we found a number of instances in which campuses included specific types of compensation, such as housing and auto allowances, in other categories not related to such allowances or in broad nondescriptive categories. Consequently, we could not determine the reliability of the amounts recorded in various compensation and funding source classifications contained within the CPS. In addition, the weaknesses of the CPS limit its usefulness as an oversight tool for the Office of the President (president's office) to monitor campuses' compliance with compensation policies. However, because the CPS is the most detailed and centrally maintained source of this information, our report presented several tables summarizing that total pay to university employees in fiscal year 2004–05 was \$9.3 billion, of which \$8.9 billion was regular pay and \$334 million was additional compensation.

- ☑ *Some university campuses circumvented or violated university policy, resulting in a \$130,000 overpayment to an employee and improper increases to others' retirement covered compensation.*
 - ☑ *The university did not consistently disclose its officers' nonsalary compensation, such as housing allowances, to the Board of Regents, as required by policy.*
-

To improve its ability to monitor campus compliance, we recommended that the president's office issue clear directives prescribing consistent use of the CPS and require campuses to consistently classify compensation into standard categories. We also suggested that the president's office consider developing additional automated controls and edits within the CPS to ensure that expenditures are properly charged and to help avoid the possibility of errors.

University's Action: Pending.

The university states that it is developing guidance to clarify and ensure the proper use of transaction codes within the CPS. As of November 2006 the university had issued draft guidelines to campuses, which are in the process of identifying the types of transactions that could cause the most concern. After putting in place guidance to provide greater clarity about the intended use of CPS categories, the university indicates it will develop appropriate edits and analysis tools to screen for anomalies. Additionally, the university states it is developing an automated system to make compensation data for the senior leadership group available for querying and reporting, and it will employ consistent and standard data definitions. The university indicates implementation of this system is on schedule and that it expects to use the system as the basis for the next annual report on senior management group compensation, which is due in March 2007.

Finding #2: The president's office regularly granted exceptions to the compensation policy.

The president's office regularly granted individuals exceptions to the university's compensation policy. University policy authorizes the president's office to approve policy exceptions that provide employees with benefits for which they otherwise would not be eligible. Seventeen of the 100 individuals in our sample benefited from an exception to policy, such as housing or moving allowances above established limits, auto allowances, or participation in the university's senior management severance pay plan.

To preserve the integrity of its compensation policies, we recommended that the president's office limit the number of exceptions to policy it allows. We suggested accomplishing this objective by the regents requiring the university to track and annually report exceptions to compensation policy that various university officers and officials grant during a fiscal year and provide justification for each exception.

University's Action: Partial corrective action taken.

The university states it hired a human resources consulting firm to perform a comprehensive review of its compensation policies, which it expects to be completed over the next 12 to 15 months. The university believes that this review will result in clearer policies on the procedures campuses must follow when seeking exceptions to policy. It has also issued an interim policy requiring campuses to document the basis and rationale for all exceptions to existing compensation policies and to report them to a newly created position of Senior Vice President—Chief Compliance and Audit Officer, which the university hopes to fill in January 2007. This position will evaluate exceptions to policy to determine if they were made in accordance with the intent of existing policy, and report any concerns to the president and the regents. In addition, the university also states that the new position will be responsible for developing additional monitoring and oversight activities.

Finding #3: The circumvention of policy caused a significant overpayment and inappropriate increases in retirement-covered compensation.

Some campuses circumvented or violated university policies, resulting in an overpayment to a university employee and questionable forms of compensation provided to others. These instances included an employee at the University of California at San Diego (San Diego) who received an overpayment of \$130,000 and a San Diego vice chancellor who continued to receive a \$68,000 administrative stipend and an \$8,900 auto allowance despite being on sabbatical. Our review also revealed that some campuses violated the university's retirement plan policy by including inappropriate forms of compensation, such as housing and auto allowances, in three employees' retirement-covered compensation, a percentage of which they may receive when they retire.

We recommended that the president's office improve its oversight of campuses' compliance with university policies by developing a mechanism to annually identify unauthorized exceptions to policy. We also recommended that the president's office determine if it is appropriate to require repayment of university funds for the instances we identified and if so, develop a repayment plan with each employee. We further recommended that the president's office remove the inappropriate forms of retirement-covered compensation we identified from the employees' retirement earnings and establish a mechanism to detect such violations.

University's Action: Partial corrective action taken.

To address our recommendation that the university annually identify unauthorized exceptions to compensation policies, the university states the comprehensive review of its compensation policies will result in improved policies on this issue. In addition, the university indicates that the newly created position of Senior Vice President—Chief Compliance and Audit Officer, will be responsible for developing additional monitoring and oversight practices for the campuses' compensation actions. The university states it has resolved the exceptions identified in our audit report by either obtaining the regents' approval of those exceptions or notifying the regents about them. At their May 2006 meeting, the regents approved guidelines for developing the corrective actions the university should take on these exceptions. At their July and September 2006 meetings, the regents' compensation committee approved the university's corrective actions for matters that arose from improper application of university policy or the failure to seek the regents' approval. For the faculty members who were not part of senior management, the exceptions were referred to academic administrators for resolution and the university indicates the action on these exceptions is pending. Additionally, the university indicates correcting all inappropriate forms of retirement-covered compensation we identified and states that its efforts to clarify the use of codes within CPS should reduce the risk of similar errors in the future.

Finding #4: The university consistently violated policies the regents established to ensure adequate review of executive compensation.

The regents' policies require them to approve all forms of compensation for officers of the university. Although the university consistently obtained approval for officers' salaries, in a sample of 10 officers we found that the university violated its policy by failing to disclose eight auto allowances, four housing allowances, two transfers of sabbatical credits, and an acceleration of health insurance contributions when the regents considered the individuals' appointment. Additionally, we found that the usefulness of the university's annual report on compensation to the regents was limited because the fiscal years 2003–04 and 2004–05 reports contained errors and were submitted late.

We recommended that the regents require the president's office to disclose all forms of compensation for university officers and for all employees whose compensation exceeds an established threshold. We further stated that this disclosure should occur when the regents approve the employees' salaries and at least annually in an accurate and timely report to the regents. Finally, the university should ensure that its annual report on compensation is accurate and timely.

University's Action: Partial corrective action taken.

In September 2006 the university developed two policies regarding how it will ensure better disclosure of employee compensation to the regents and the public. These practices include specifically identifying the elements of employee compensation to disclose in its annual report on senior management compensation, and for recent hires of executives and those earning an amount that requires the regents' approval, and the methods it will use to disclose this information. Additionally, the university has developed a compensation checklist, which it indicates the regents receive when approving employee compensation. The university asserts that the new system containing compensation data for the senior leadership group, which it is currently implementing, will substantially improve the quality of information included in its annual report on senior management group compensation to the regents.

DEPARTMENT OF EDUCATION

Its Flawed Administration of the California Indian Education Center Program Prevents It From Effectively Evaluating, Funding, and Monitoring the Program

REPORT NUMBER 2005-104, FEBRUARY 2006

Audit Highlights . . .

Our review of the management of the California Indian Education Center program (program) by the Department of Education (department) found that:

- Because the department has largely ignored the existing guidance for administering the program, it cannot ensure that the program is successfully meeting the established goals or the needs of the communities it serves.*
- The department did not ensure that California Indian Education Centers (centers) reported all the annual data required by law to measure performance.*
- The department has no record of the centers' assessments of needs called for by the guidelines adopted by the State Board of Education and thus has no way of knowing whether the services the centers assert they provide are those most needed by the populations they serve.*

continued on next page . . .

Department of Education's response as of October 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Department of Education's (department) administration of the California Indian Education Center program (program), how it determines funding for the California Indian Education Centers (centers), and how it evaluates them. Specifically, the audit committee asked us to determine the department's roles and responsibilities related to the centers and to review and evaluate the department's existing policies, procedures, and practices for administering the program and monitoring the centers. The audit committee was also interested in any written procedures the department has developed to guide program administration. In addition, it asked us to review the department's funding structure for the program and how it appropriates funds to administer the program.

Further, the audit committee requested that we assess the reasonableness of the department's uses of program funds; determine whether it has directed sufficient resources to the program in general and sufficient management attention to completing the program evaluation report that was due to the Legislature on January 1, 2006; and review the department's document retention policies and practices. Finally, the audit committee asked us to review and evaluate the department's process for allocating and disbursing funds to the centers. We found that, despite established guidance, the department has not adequately administered the program and consequently cannot ensure that the program is successfully meeting the goals established in law or the needs of the communities it serves.

Finding #1: The department does not know how the program is performing.

Despite established guidance, the department has not adequately administered the program and consequently cannot ensure that the program is successfully meeting the goals established in law or the needs of the communities it serves. To address the challenges facing

- ☑ *Though submitted to the Legislature on time, the department's evaluation of the program lacks sufficient analysis to adequately support its recommendations to improve the program.*
 - ☑ *The department is unable to justify its basis either for selecting centers to receive funding or for determining the annual amount of funding it grants each center.*
 - ☑ *The department has not always promptly disbursed funds to the centers.*
 - ☑ *The department lacks a monitoring process to ensure that centers spend funds appropriately, pursue program goals, and report accurate data.*
-

American Indian students enrolled in California's public schools—low academic achievement at all grade levels, high dropout rates, and few students continuing their education beyond high school—the Legislature established the program in 1974. The legislation indicated that the centers should serve as educational resources for American Indian students, their parents, and the public schools. In addition, to guide the operation of the centers, the Legislature established a set of goals, such as improving the academic achievement, self-concept, and employment opportunities of American Indian students and adults. From its initial 10 centers funded by a total of \$400,000 in grants, the program has grown to comprise 30 centers that annually receive more than \$4.4 million in total funding as of fiscal year 2005–06. If not reauthorized, the program is set to end on January 1, 2007.

The department is required by state law to administer and oversee the program and receives guidance from legislation as well as internal policies. For instance, state law requires the department to collect data annually to measure the academic performance of the students the centers serve and how well the centers are meeting the goals established by law. Additionally, although no regulations govern the program, state law requires the State Board of Education (board) to adopt guidelines for selecting and administering the centers. The guidelines the board adopted in 1975 require, among other things, that centers design their programs after assessing the needs of their respective communities. Internal guidance comes from the department's 2001 Grant Administration Handbook (handbook), which guides the administration of programs funded by grants similar to those used in this program. The handbook stipulates that the department establish a competitive process to objectively select grant recipients, a monitoring plan to ensure that grant recipients appropriately implement the program, and a document retention and filing process to effect stable program administration and clear communication between the department and the centers.

However, the department has largely ignored the existing guidance for administering the program and therefore has little means of determining program effectiveness. For example, until 2005 the department did not ensure that centers reported the annual academic performance data of their students.

Another indication of the department's flawed administration of the program is its inability to fully justify its basis either for initially selecting centers to receive funding or for determining the annual amount of funding it grants each center. According to the handbook, it should select grant recipients following a competitive process, which

includes an objective scoring methodology and independent raters. However, the department could not demonstrate that it used a competitive process to select the most recent centers currently funded. Further, although program staff state that the department's sole basis for computing the amount that each center receives is the amount granted in the previous fiscal year, it has not consistently followed that method.

Further, the department has not always promptly disbursed funds to the centers. Despite the department's informal policy that it would issue the first of three annual installment payments to centers with approved applications an estimated six to 10 weeks after the governor signs the state budget, in fiscal year 2003–04 the centers did not receive their first grant allocations until December—18 weeks after the budget was approved.

Finally, the department lacks a monitoring process to ensure that centers spend funds appropriately, pursue program goals, and report accurate data to the department. Without operating policies and procedures outlining how staff should consistently administer the program, the department may create confusion among the centers. The department indicates that it is attempting to improve its administration of the program by proposing more detailed legislation to reauthorize the program and by developing a plan for monitoring the centers, but these efforts are too preliminary for us to assess.

To ensure that it administers the program clearly, consistently, and effectively, we recommended that the department develop operating policies and procedures specific to the program and train staff in their application. The policies and procedures should include the following:

- A description of the data that centers must annually report to measure program performance and a standardized format for reporting to allow the department to effectively aggregate and consolidate the data for reports to the Legislature and other interested parties. Further, the department should outline the consequences for failing to submit the data.
- An equitable process to select centers to receive grant awards and determine their respective funding amounts.
- A set time frame that it adheres to for disbursing payments to the centers once their applications are received and approved. The time frame for the first payment can be expressed as a set number of weeks after enactment of the state budget for centers with approved applications.
- A centralized filing system that contains all documents pertinent to the grant program, including documentation of the technical assistance provided to the centers.
- A monitoring process and plan to ensure that reported fiscal and program information is accurate and complete, including a process for corrective action and departmental follow-up for noncompliance.
- A set schedule indicating how long program records are to be kept.

Department's Action: Partial corrective action taken.

According to the department, there is legislation (SB 1710) that, when enacted on January 1, 2007, will change the program's application and reporting requirements beginning in fiscal year 2007–08. In the interim, the department adopted certain operational policies and procedures that included:

- Developing the fiscal year 2006–07 application packets that instruct the centers on what they are required to report. Training on the application process was provided to center directors in January and May 2006.
- Revising the end-of-year report to address all statutory reporting requirements after receiving input from the center directors. The report was designed so that the information could be aggregated and consolidated, and clear consequences were communicated for failure of the centers to report the information required.
- When SB 1710 is enacted, the department stated it would follow policies and procedures in accordance with the new statute for selecting centers to receive grant awards and determine funding amounts.
- The department indicated that it had included set time frames within which it would make periodic payments to the centers in a letter to the centers' directors. However, the letter to which the department refers does not contain this information.
- Establishing a centralized filing system for the center grant program.
- Scheduling 10 centers for monitoring visits during fiscal year 2006–07. The department was silent concerning a process to ensure corrective actions are taken when needed and followed-up for compliance.
- Approving a record retention schedule that indicates how long various records will be retained.

Finding #2: With staff unaware of guidelines requiring needs assessments, the department does not know if centers have designed their programs to meet community needs.

The department has no record of the centers' needs assessments on file and thus has no way of knowing whether the services the centers assert they are providing are the services most needed by the populations they serve.

To ensure that centers use program funds effectively, we recommended that the department ensure that they periodically conduct needs assessments as required by the guidelines adopted by the board.

If the Legislature decides to reauthorize the program, we recommended that it consider requiring annual or biannual reports from the department to monitor the progress of the program and supplement the report the department submitted to the Legislature by the due date of January 1, 2006. Alternatively, the Legislature might want to extend the life of the program in one- or two-year increments to augment the data available for evaluation.

Department's Action: Pending.

When SB 1710 is enacted, the centers will be required to conduct and submit the results of a needs assessment as part of the 2007 through 2012 application cycle.

Legislative Action: None.

The Legislature did not choose to implement our suggestions regarding our recommendation for considering requiring the department to submit annual or biannual reports monitoring the progress of the program or, alternatively, extending the program in one- or two-year increments.

DEPARTMENT OF HEALTH SERVICES

Participation in the School-Based Medi-Cal Administrative Activities Program Has Increased, but School Districts Are Still Losing Millions Each Year in Federal Reimbursements

Audit Highlights . . .

Our review of the Department of Health Services' (Health Services) administration of the Medi-Cal Administrative Activities program (MAA) revealed the following:

- School districts' participation in, and reimbursements for, MAA have significantly increased since fiscal year 1999–2000.***
 - Despite receiving \$91 million for fiscal year 2002–03, we estimate school districts could have received at least \$57 million more had all school districts participated and certain districts fully used MAA.***
 - Health Services has not performed a sufficient number of local on-site visits.***
 - Simplifying the MAA structure would increase efficiency and simplify program oversight.***
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REPORT NUMBER 2004-125, AUGUST 2005

Department of Health Services' response as of July 2006

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to review the Department of Health Services' (Health Services) administration of the Medi-Cal Administrative Activities program (MAA). Specifically, we were asked to assess the guidelines provided by Health Services to local educational consortia (consortia) and local governmental agencies that administer MAA at the local level. Additionally, the audit committee asked us to evaluate the process by which Health Services selects consortia and local governmental agencies to contract with, how it establishes the payment rates under the terms of the contracts, and how it monitors and evaluates performance of these entities.

We were also asked to evaluate the effectiveness of a sample of consortia and local governmental agencies in administering MAA and in ensuring maximum participation by school districts. Furthermore, we were requested to conduct a survey of school districts regarding their participation in the program.

Finding #1: School districts underused MAA.

Although California school districts received \$91 million in federal MAA funds for fiscal year 2002–03, we estimate that they could have received at least \$53 million more if all school districts had participated in the program and an additional \$4 million more if certain participating school districts fully used the program. School districts we surveyed identified a belief that the program would not be fiscally beneficial as one of the primary factors in their decision not to participate in MAA. However, several of the nonparticipating school districts we surveyed have not recently assessed the costs and benefits of the program, while many of the surveyed school districts that recently performed this assessment have now decided to participate. The main reasons offered by consortia and local governmental agencies as to why participating school districts did not fully use MAA were that they lacked an experienced MAA coordinator with sufficient time to focus on the program and generally resisted or lacked support for time surveying. If such issues are addressed, school districts may be able to obtain additional MAA reimbursements beyond our \$57 million estimate.

Health Services and the consortia and local governmental agencies that help it administer the program have not done enough to help school districts participate in MAA. Health Services acknowledges that it does not try to increase MAA participation and federally allowable reimbursements, commenting that it has neither a mandate nor the resources to do so. However, it is the state entity in charge of Medi-Cal and could use its contracts with these local entities to mandate their performance of outreach activities designed to increase the use of MAA. None of the local governmental agencies we visited perform any outreach activities. Conversely, consortia have already voluntarily assumed some responsibility for increasing program participation in their regions even though Health Services does not contractually obligate them to do so. Consequently, Health Services has not established ways to measure and improve these outreach efforts. Consortia could improve their outreach to school districts by targeting nonparticipating school districts that have the potential for a high MAA reimbursement and by identifying participating school districts that underuse MAA and helping ensure that they have a correct understanding of those costs that are federally reimbursable.

To help ensure comprehensive MAA participation by school districts and that all federally allowable costs are correctly charged to MAA, Health Services should require consortia to perform outreach activities designed to increase participation and hold them accountable by using appropriate measures of performance. In addition to the mass forms of outreach consortia currently perform, Health Services should require them to periodically identify and contact specific nonparticipating school districts that have potential for high MAA reimbursement and periodically identify and contact participating school districts that appear to be underusing MAA to help ensure that they have a correct understanding of those costs that are federally reimbursable. If Health Services believes it does not have a clear directive from the Legislature to increase participation and reimbursements, it should seek statutory changes.

Health Services' Action: Partial corrective action taken.

Health Services amended its MAA contracts to include the requirement that consortia perform targeted outreach activities each year to a minimum of 15 percent of all nonparticipating school districts within their region that have the highest daily attendance. Health Services uses a site review tool to measure contractual compliance and adherence to program directives.

Health Services' School-Based MAA Unit provides ongoing consultation and program expertise to consortia to ensure that they have a correct understanding of those costs that are federally reimbursable. The unit also develops and conducts annual mandatory training for time surveys. Additionally, the unit's MAA database of participating and nonparticipating school districts by region has established baseline references to measure outreach activities. Finally, an annual report of participation information and performance measures is being developed for additional program oversight.

Finding #2: Without regular site visits, Health Services cannot determine if local entities complied with MAA requirements.

Health Services did not adequately monitor the MAA activities of consortia, local governmental agencies, or school districts. Effective November 2002, the federal Centers for Medicare and Medicaid Services (CMS) required Health Services to perform on-site reviews of each consortium and local governmental agency at least once every four years. According to the CMS requirements, these reviews may be performed in one of two ways. Health Services can elect to review a representative sample of claiming units—the entities within a consortium or local governmental agency, including school districts, that participate in MAA. Alternatively, the consortia and local governmental agencies can focus a portion of their annual single audit on MAA claiming every four years. However, based on our review, neither method was consistently employed.

From October 2001 to February 2005, Health Services conducted site visits of only nine of 31 consortia and local governmental agencies, including some school districts. During that period, it did not conduct any site visits during 2003 and only one during 2004. Additionally, four of the five consortia—the Los Angeles consortium performed some reviews—and three of the four local governmental agencies we reviewed did not perform onsite reviews of school districts. According to the chief of administrative claiming, Health Services has implemented new procedures as a result of its most recent MAA manual approved by CMS in August 2004 and has received the authority to hire additional staff to help implement the new manual, including performing site visits. According to the manual, Health Services is required to conduct site visits at a minimum of three consortia and one local governmental agency each year.

Health Services should ensure that the site visits of consortia, local governmental agencies, and school districts are conducted as required.

Health Services' Action: Corrective action taken.

The School-Based MAA Unit is now fully staffed. Oversight, monitoring, site visit and desk review protocols, and performance criteria are in place and exceed federal monitoring requirements. With the increased staff in the School-Based MAA Unit, regular mandatory site visits are occurring along with desk reviews of 50 time surveys and 100 invoices yearly for all of the consortia.

Finding #3: Health Services' existing procedures limit its ability to effectively measure MAA performance.

Health Services has decreased the time it takes to pay an invoice, but its current invoice and accounting processes need to be updated so that it can more easily collect data to monitor MAA and to identify where additional improvements could be made. For instance, because it uses a manual process, which has the potential for human error, Health Services cannot easily determine the total federal reimbursements California schools have received from MAA, identify participating school districts, or ascertain the amount each school district receives in MAA reimbursements. Without these basic statistics, it is difficult for Health Services to adequately monitor the success of the program, and its ability to use statistical methods to identify fraudulent or excessive claims is limited. It also does not require regular reporting from consortia and local governmental agencies on their program efforts (annual reports). Further, Health Services has not established a way to measure the performance of consortia and local governmental agencies, and has not outlined the actions it would take if one of these entities consistently neglected their responsibilities.

Health Services should update its current invoicing and accounting processes so it can more easily collect data on the participation and reimbursement of school districts. Additionally, Health Services should require consortia, and local governmental agencies should they continue to be part of MAA, to prepare annual reports that include participation statistics, outreach efforts and results, and other performance measures Health Services determines to be useful. Health Services should then annually compile the content of these reports into a single, integrated report that is publicly available. Finally, Health Services should develop written criteria for consortia, and local governmental agencies should they continue to be part of MAA, and take appropriate action when performance is unsatisfactory.

Health Services' Action: Partial corrective action taken.

Refinements to the invoice and accounting processes have been implemented. Invoice and claiming plan backlogs have been eliminated, and staff are meeting all deadlines. Additionally, Health Services has begun the MAA Automation project and has hired a consultant to develop a feasibility study scheduled to be completed by September 2006. The MAA Automation project will enable Health Services to analyze MAA data and develop management reports. Data collection and analysis and management reports focus on total federal MAA reimbursements, participating school district MAA reimbursements, and consortia performance measures, among other indicators. Additionally, Health Services and MAA coordinators have formed an "Annual Report Workgroup" to develop and finalize a yearly report that will be published on Health Services' Web site. The workgroup has developed interim management reports using existing data to identify trends within California and in comparison with other states.

Health Services' School-Based MAA Unit is actively assessing local MAA performance through site reviews and desk reviews to identify and correct unsatisfactory performance. The School-Based MAA Unit staff are correcting overpayments and repayments, returning incorrect invoices, and requiring improper invoice revisions to ensure program consistency and compliance. Health Services also continues to develop MAA policy and procedures letters to provide program guidance and directives to ensure proper and efficient implementation of the MAA program.

Finding #4: Some consortia and local governmental agencies are charging fees in excess of their administrative costs.

School districts are receiving a reduced share of MAA reimbursements because some consortia and local governmental agencies are charging fees that exceed their administrative costs. Furthermore, representatives for three of the local governmental agencies we reviewed stated they do not perform an analysis that would allow them to identify whether the fees they assessed exceeded their costs. State law requires that Health Services contract with a consortium or local governmental agency to claim MAA reimbursement for a participating school district and allows that administering entity to collect a fee from the school district for such a service. We reviewed fees assessed by some of these entities, anticipating that the fees charged would be sufficient to cover the administrative costs incurred. However, we found that the fees charged by some consortia and local governmental agencies exceeded costs. This condition does not result in the State receiving additional MAA funds from the federal government. Rather, it results in the school districts receiving a smaller share of MAA reimbursements than they could have. Health Services stated it has not developed policies governing consortium and local governmental agency fees because it was unaware of the overcharging issue.

Health Services should develop policies on the appropriate level of fees charged by consortia to school districts and the amount of excess earnings and reserves consortia should be allowed to accumulate. Health Services should do the same for local governmental agencies if such entities continue to be part of the program structure.

Health Services' Action: None.

Health Services' research found no federal authority to implement policies regarding the level of consortium fees or the amount of excess savings or resources the consortium can accumulate. Health Services believe that this issue should be handled at the local level to afford maximum flexibility to manage the program on local issues. We continue to believe it is critical that Health Services develop policies in this area. If Health Services believes it needs express authority to implement such policies, it should seek it.

Finding #5: Some school districts are losing money because of the terms of their vendor contracts.

School districts we reviewed lost an estimated \$181,000 in federal MAA reimbursements for fiscal year 2003–04 because the fees they paid their vendors were based on the amount of MAA reimbursements they received. Although federal guidance has long prohibited requesting reimbursement for these types of fees, known as contingency fees, it was not until recently that Health Services issued guidance on this topic. In its 2004 MAA manual, Health Services indicates that claims for the costs of administering MAA may not include fees paid to vendors that are based on, or include, contingency fee arrangements. Although this guidance is helpful, it does not identify alternative fee arrangements that would allow federal reimbursement for vendor fees. Consequently, school districts may mistakenly believe vendor fees are not reimbursable under any circumstances.

We recommended that Health Services help school districts invoice for all reimbursable costs, including vendor fees, by issuing clear guidance on how to invoice for these costs and instructing consortia, and local governmental agencies should they continue to be part of MAA, to make sure school districts in their respective regions know how to take advantage of these revenue-enhancing opportunities.

Health Services' Action: Corrective action taken.

Health Services is fully staffed and the local MAA programs are receiving ongoing technical assistance, training, and guidance in obtaining all appropriate reimbursements under the MAA program.

Finding #6: Because of recent changes in billing practices, the federal government could be billed twice for the same services.

Some consortia and local governmental agencies are changing their fee structures to allow school districts to claim their fees as a federal reimbursable MAA cost. However, because consortia and local governmental agencies also request federal reimbursement for their administrative costs, this practice could result in the federal government reimbursing both a consortium or local governmental agency and a school district for the same services. Health Services has not adequately monitored the activities of these entities and therefore was unaware of these changes at the local level. Consequently, Health Services has not created the policies necessary to prevent activities from being claimed twice. Although we did not identify any duplicate payments to the entities we reviewed, the potential for duplicate payments exists.

We recommended that Health Services follow through on its plans to develop a policy governing the claiming of consortium and local governmental agency fees and instruct these entities to carefully monitor school districts' invoices to make sure that any claiming of consortium or local governmental agency fees does not result in duplicate payments.

Health Services' Action: Corrective action taken.

Health Services released a policy and procedure letter in February 2006 that requires consortia or local governmental agencies participating in MAA to ensure, by monitoring invoices, that administrative fees they charge school districts are not reported by both the consortia or governmental agencies and the school districts. The policy and procedure letter further provides that the cost of activities included on the MAA invoice may only be claimed by one entity. Therefore, if the activities are claimed on the consortia or governmental agency invoice, they may not be claimed on other invoices, such as the school district or subcontractor invoices.

Finding #7: Simplifying the MAA structure would make the program more efficient and effective.

MAA would be more efficient and effective if Health Services required participating school districts to submit invoices through a consortium and to use a vendor selected through a regionwide competitive process. School districts currently submit MAA invoices through 11 different consortia and 20 different local governmental agencies. To ensure that it adequately monitors the activities of these two sets of local administering entities, Health Services plans to conduct site visits of all 31 once every three years. However, although local governmental agencies represent nearly 65 percent of the 31 site visits to be performed, school districts only submit about 24 percent of their MAA invoices through local governmental agencies. Once Health Services implements the additional monitoring activities we recommend, its efforts would be better spent on the 11 consortia that process 76 percent of participating school districts' MAA invoices. Using such an approach, it would likely be able to increase its oversight activities without requiring a significant increase in staff resources.

We also recommended that Health Services require consortia to perform outreach activities designed to increase MAA participation and that it hold consortia accountable using appropriate measures of performance. We did not include local governmental agencies in this recommendation because the jurisdictions of consortia and local governmental agencies overlap. Efforts by both consortia and local governmental agencies to conduct outreach to the same school districts not participating in MAA would be a duplicative use of resources. In addition, if Health Services required simultaneous outreach efforts by consortia and local governmental agencies, it could confuse school districts and reduce the accountability of both entities for their outreach programs. Consortia are best suited to perform outreach to nonparticipating school districts because they are administered by educational units and thus may have a better understanding of school districts' needs than would local governmental agencies, which are typically county health agencies.

Finally, if each school district that needs MAA assistance is required to use a vendor competitively selected by its consortium, instead of entering into an individual contract with a vendor of its own choosing, vendors could be subject to stronger oversight and compelled to reduce their fees. Nearly all of the 27 participating school districts that responded to our survey used private vendors for some sort of MAA assistance. Some of these school districts used a vendor selected by consortia, but because not all consortia contract with vendors, many school districts do not have that option. Other school districts choose to contract directly with private vendors for MAA assistance, even though their consortia also contracted with vendors. This makes oversight of vendors difficult and does not take advantage of the volume discounts consortia may be able to achieve.

Health Services should reduce the number of entities it must oversee and establish clear regional accountability by eliminating the use of local governmental agencies from MAA. Because current state law allows school districts to use either a consortium or a local governmental agency, Health Services

will need to seek a change in the law. Additionally, we recommended that Health Services require school districts that choose to use the services of a private vendor, rather than developing the expertise internally, to use a vendor selected by the consortium through a competitive process. Depending on the varying circumstances within each region, a consortium may choose to use a single vendor or to offer school districts the choice from a limited number of vendors, all of which have been competitively selected. Health Services should seek a statutory change if it believes one is needed to implement this recommendation.

Health Services' Action: None.

Health Services disagrees with our recommendation to eliminate the use of local governmental agencies from MAA. Specifically, Health Services continues to support the school districts' decision to claim through either their consortia or their local government. Health Services believes this local flexibility allows MAA program implementation to be based on local variances and results in the most efficient use of resources.

Health Services agrees with the merits of requiring school districts that choose to use the services of a private vendor rather than develop the expertise internally to use a vendor selected by the consortium after a competitive selection process. However, Health Services continues to support local flexibility to allow management of the MAA to be based on local variances resulting in the most efficient use of local resources. Nevertheless, we continue to believe that simplifying the MAA structure to make the program more efficient and effective is important, and thus, Health Services should implement the recommendations. Further, Health Services should seek a statutory change if it believes one is needed to implement the recommendation regarding vendor selection.

DEPARTMENT OF EDUCATION

School Districts' Inconsistent Identification and Redesignation of English Learners Cause Funding Variances and Make Comparisons of Performance Outcomes Difficult

REPORT NUMBER 2004-120, JUNE 2005

Audit Highlights . . .

Our review of the administration and monitoring of English learner programs by the Department of Education (department) and a sample of school districts found that:

- The department provides school districts leeway in setting certain criteria they use to identify students as English learners and to redesignate them as fluent.*
- Differences in school districts' identification and redesignation criteria cause funding variances and a lack of comparability in performance results.*
- Sixty-two percent of the 180 English learners we reviewed, who were candidates for redesignation but had not been redesignated, met school districts' criteria for fluent status but were still counted as English learners.*
- School district and department monitoring of schools' adherence to the redesignation process is inadequate.*
- Of 180 tested expenditures, eight were for unallowable purposes and 43 were questionable.*

continued on next page . . .

The Department of Education's response as of December 2006 and eight school districts' responses as noted in districts' action headings¹

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review the administration and monitoring of state and federal English learner program (English learner) funds at the Department of Education (department) and a sample of school districts. Specifically, the audit committee asked us to examine the processes the department and a sample of school districts use to determine the eligibility of students for the English learner programs, including an evaluation of the criteria used to determine eligibility for these programs and a determination of whether school districts redesignate students once they become fluent in English. In addition, the audit committee asked us to review and evaluate the department's processes for allocating program funds, monitoring local recipients' management and expenditure of program funds, and measuring the effectiveness of the English learner programs. Lastly, the audit committee asked us to, for selected school districts, test a sample of expenditures to determine whether they were used for allowable purposes. We focused our audit on the three main English learner programs whose funds are distributed by the department—federal Title III-Limited English Proficient and Immigrant Students (Title III), state Economic Impact Aid (Impact Aid), and the state English Language Acquisition Program (ELAP). In doing so, we noted the following findings:

Finding #1: School districts are inconsistent in the criteria they use to identify and redesignate English learners.

Although the department has provided guidance to school districts for establishing criteria to identify students as English learners and to redesignate them as fluent in English, it has allowed the school

¹ The eight school districts we reviewed are: Anaheim Union High School District (Anaheim), Long Beach Unified School District (Long Beach), Los Angeles Unified School District (Los Angeles), Pajaro Valley Unified School District (Pajaro), Sacramento City Unified School District (Sacramento), San Diego City Unified School District (San Diego), San Francisco Unified School District (San Francisco), and Stockton Unified School District (Stockton).

- ☑ *The department performs limited monitoring of school districts' expenditure of English learner program funds.*
 - ☑ *The State's evaluation of the impact of particular English learner programs is weak.*
 - ☑ *The funding formula for Impact Aid is complicated and likely outdated.*
-

districts some latitude in setting test score thresholds for redesignation. State law requires school districts to use California English Language Development Test (CELDT) results as the primary indicator for their initial identification of pupils as English learners, and as the first of four specific criteria for redesignating English learners as fluent. State law also requires the department, with the approval of the California State Board of Education (board), to use at least the four criteria defined in law to establish procedures for redesignating English learners to fluent status. In September 2002, the department published board-approved guidance for school districts to use in developing their initial and redesignation criteria. The department's guidance on redesignation criteria consists of student performance on the CELDT and the California Standards Test (CST) in English Language Arts (CST-ELA), as well as a teacher evaluation of academic performance, and parental opinion. However, because these are not regulations, school districts are not required to adhere to the department's guidelines. As a result, school districts' criteria for the initial identification of English learners vary and some school districts have established more stringent criteria that their English learners must meet to attain fluent status when compared to other school districts. In noting this fact, we are not concluding that a particular criterion or scoring standard is preferable to another, but rather that inter-district variation exists.

We recommended that the department, in consultation with stakeholders, establish required initial designation and redesignation criteria related to statewide tests that would provide greater consistency in the English learner population across the State. The department should pursue legislative action, as necessary, to achieve this goal. Further, school districts should ensure that their redesignation criteria include each of the four criteria required by state law for redesignating English learners to fluent status.



Department's Action: None (one-year response as of August 2006).

The department states that guidance on the redesignation of English learners is in accord with current law and that if the law changes and flexibility is impacted, it will consult with stakeholders. The department does not indicate that it has taken any action to consult with stakeholders or to seek legislation to provide greater consistency in the English learner population across the State.

Stockton's Action: Corrective action taken.

Stockton's redesignation form now covers the four criteria required by state law, including a section for teacher comments and documentation.

Finding #2: Inadequate monitoring of the redesignation process causes students who have met school district criteria for fluency to remain in the English learner population.

Although the schools we reviewed generally were consistent in adhering to their districts' initial identification processes, we noted that most of the same schools failed to fully complete, and in some cases even begin, the process of redesignating English learners to fluent status. In reviewing redesignations at eight school districts, we found that 111 (62 percent) of the 180 English learners we reviewed met the school districts' redesignation criteria but had not been redesignated as fluent in the school district records. We focused our testing on English learners who were candidates for redesignation in fiscal year 2003-04, but who had not been redesignated as fluent. There were about 42,000 such students at the eight school districts we reviewed. Further, although state regulations require school districts to maintain in students' records documentation of input from teachers, other certified staff, and parents regarding redesignation, almost none of the students we reviewed who met school district criteria for fluency had documentation in their records explaining why they were still designated as English learners. We also found that an additional 21 of the students we reviewed had been redesignated as fluent, according to documentation at their schools, but continued to be reported as English learners in the districts' student databases and reported as such to the department. When these databases overstate the number of English learners, school districts receive more funding than they are entitled to receive.

One factor contributing to these errors is the inadequate monitoring effort school districts employ to ensure that schools adhere to their redesignation processes. Another factor is the department's coordinated compliance review (compliance review), which includes testing of fluent students to ensure that they meet redesignation criteria, but did not, until May 2005, include guidance for its consultants to test current English learners' records to ensure that they are designated correctly. Without adequate monitoring, the school districts and the department lack assurance that English learners who have met the criteria for fluency are consistently redesignated.

We recommended that the department require school districts to document redesignation decisions, including decisions against redesignating students who are candidates for fluent status. Further, we recommended that school districts monitor their designation and redesignation processes more closely to ensure that schools actually complete the process and that school district databases accurately reflect all redesignations.

Department's Action: None (one-year response as of August 2006).

The department's 2005-06 English Learner Monitoring Instrument, posted on its Web site, includes a requirement to document redesignation decisions. The department says that it has distributed this instrument at various meetings and trainings throughout the State.

Anaheim's Action: Corrective action taken (one-year response as of June 2006).

Anaheim stated that in the summer of 2005 it implemented a process for obtaining the latest information on the English proficiency status of students entering its schools from elementary feeder districts and for updating its junior high student records accordingly. Further, Anaheim says that it has reviewed English learner cumulative files at most of its schools. The district also indicates that in the winter of 2006, it undertook a concerted effort to redesignate the

maximum number of eligible students. To facilitate this process it streamlined instructions and reevaluated its redesignation criteria, adding a page to its form to allow redesignation teams to clarify and memorialize their thinking process relative to final redesignation decisions.

Note: Anaheim did not need to respond to the recommendation related to school district expenditures.

Long Beach's Action: Corrective action taken (one-year response as of October 2006).

Long Beach stated that in the last 18 months it has implemented automated procedures to facilitate additional monitoring of student designations and redesignations. It said that three times a year it creates lists of students eligible for redesignation. School sites use these lists to complete the redesignation process including collecting teacher and parent input. The district's redesignation forms now include a section that clearly indicates why students who were not redesignated have been retained as English learners.

Los Angeles' Action: Corrective action taken (one-year response as of June 2006).

Los Angeles says that it modified its student information databases to automatically redesignate English learners when they meet district criteria and a parent notification letter has been printed. It also indicated that its Language Acquisition Branch is reviewing district data to monitor the redesignation process for students meeting district criteria.

Pajaro's Action: Corrective action taken (one-year response as of December 2006).

Pajaro stated that in September 2006 the district's Program Evaluation unit developed possible candidates for redesignation based on CST and CELDT scores. Bilingual Resource Teachers then collected redesignation completed forms and sent a copy to the district's director of Federal and State Programs who reviewed the documents for accuracy. An audit of the Student Information System was completed to ensure that redesignated students were coded as fluent in English. For students that qualify for redesignation based on test scores but who remain English learners, schools must explain their decision to deny redesignation and maintain supporting evidence.

Sacramento's Action: Partial corrective action taken (six-month response as of January 2006; no one-year response provided).

Sacramento says that it has modified its processes to include new monitoring standards. In addition, Multilingual Education Specialists formally monitor English learner items within the database for compliance three times a year, and documentation is sent to the associate superintendent for review.

San Diego's Action: Partial corrective action taken (one-year response as of October 2006).

San Diego indicates that it sent a memorandum to all district principals in September 2005 outlining redesignation criteria and that it offered redesignation workshops in November 2005. In addition, it sent a plan for monitoring and evaluating English learner programs to the department in October 2005 that identified staff responsible for supporting and monitoring the redesignation process, but did not establish specific processes for monitoring redesignations.

San Francisco's Action: Partial corrective action taken (one-year response as of December 2006).

San Francisco stated that in the fall of 2006, it provided training to principals and teachers on compliance requirements related to redesignations. It also indicated that it has monitored redesignations during principal evaluations. In addition, San Francisco says that consultants and the executive directors of its Multilingual Programs, and Research and Evaluation units will meet regularly to monitor the effectiveness of the data collection and reporting system in accurately reflecting all redesignations.

Stockton's Action: Partial corrective action taken (six-month response as of November 2005; no one-year response provided).

Stockton says it revised its Master Plan to include a section that addresses redesignation monitoring, specifically the timely and accurate data entry of redesignated students. The district also stated that in order to keep its database current, it has re-instituted a bi-monthly process to follow up with schools.

Finding #3: Diverse designation and redesignation criteria and inconsistent implementation of these criteria may cause funding variances and hinder comparisons of performance results.

School districts' use of more stringent designation and redesignation criteria, and a failure to implement redesignation criteria, can positively affect their funding and the outcomes for one of the three annual measurable achievement objectives (annual objectives) the department has established in accordance with Title III of the federal No Child Left Behind Act of 2001. Taking in and retaining high-scoring English learners gives some school districts a funding advantage because funding formulas are based on English learner counts. The inclusion and retention of more-advanced students also can be expected to make it easier for these districts to meet one of the annual objectives.

Title III and ELAP funding is linked directly to English learner counts. Impact Aid funding also takes into account the number of English learners. School districts that opt for more stringent designation and redesignation criteria increase their English learner counts and in turn increase their English learner funding. Furthermore, school districts that do not fully implement their established redesignation criteria and thus fail to redesignate all eligible students maintain higher English learner counts and receive higher funding than otherwise would be the case. However, we found varying designation and redesignation criteria, as well as numerous errors in the redesignation process, at all sampled school districts. Therefore, we cannot determine how much of an effect divergent criteria and a failure to implement these criteria have on English learner funding.

Further, school districts with relatively stringent initial designation and redesignation criteria may find it easier to meet the annual objective that measures students' progress in learning English because they tend to have higher percentages of students who have attained proficiency on the CELDT. According to this objective, English learners attaining proficiency on the CELDT need only maintain their proficiency to meet the annual progress target, while those who do not attain proficiency must improve their proficiency level to meet the objective. Based on statewide department data, in fiscal year 2003–04, 77 percent of English learners who previously attained proficiency on the CELDT were able to maintain their proficiency level, while only 57 percent of English learners who had not attained proficiency on the CELDT were able to improve their overall proficiency level. Consequently, performance results for this objective are probably skewed by the varying redesignation policies, and it is questionable whether these performance results are really comparable across school districts.

We recommended that the department consider changing the annual objective that measures students' annual progress in learning English to offer less incentive for school districts to maintain students as English learners.

Department's Action: Partial corrective action taken (one-year response as of August 2006).

The department states that a bookmark standard setting procedure for the CELDT was held in February 2006 and that as part of this procedure the minimum scores for the Early Advanced and Advanced levels were raised. The department does not, however, indicate that it changed the basic structure of the objective. The department expects that the change in the minimum scores will result in fewer students scoring at the English proficient level of the CELDT who do not meet the academic criteria for redesignation. The new performance levels will apply to CELDT results and Title III annual objectives for the 2006–07 school year.

Finding #4: Minimal monitoring of expenditures allows school districts to use some funds for unallowable costs.

The total funding for the three largest English learner programs was roughly \$605 million in fiscal year 2003–04, and the department distributed most of these funds to school districts. These funds must be used exclusively for supplementary services and activities geared toward the English learner population for each of the three programs. However, the department provides little guidance to school districts on how to document their use of these funds, and it does limited monitoring of the districts' expenditures, thus increasing the risk that these funds may be used for unintended purposes. In fact, we noted that some school districts have inadequate documentation practices and sometimes spend funds for unallowable or questionable purposes. Of the 180 expenditure transactions we tested, eight were for unallowable purposes and 43 were questionable. Most of the questionable expenditures related to purchases that had no contemporaneous documentation linking the expenditures to English learners or were for transactions for the purchase of goods or services that included non-English learners as well as English learners.

For example, Los Angeles used Title III funds to make two separate purchases, totaling nearly \$3.8 million, of mathematics materials for students in general instructional programs—an unallowed use of these funds. In addition, Stockton and Los Angeles spent ELAP funds at schools or on activities that are not covered by the grant award. Los Angeles spent \$11 million in ELAP funds in fiscal year 2003–04 on an extended learning program that covered a range of underachieving students in kindergarten through eighth grade, even though ELAP funds are restricted to English learners in grades four through eight.

We recommended that the department perform the steps necessary to ensure the school districts we reviewed have taken appropriate action to resolve their unallowable expenditures of supplemental English learner program funds. In addition, we recommended the department revise the documentation policy it provides to school districts to better ensure that expenditures are directed clearly at activities that serve the English learner programs' target populations. Lastly, to ensure that expenditure files clearly demonstrate that supplemental English learner program funds are directed at activities that serve the law's target populations, we recommended that school districts implement documentation policies.

Department's Action: Partial corrective action taken (one-year response as of August 2006).

The department says it has verified that the school districts either transferred or reimbursed the unallowable expenditures of supplemental English learner program funds identified in the report. The department also states it has informed school districts that expenditures charged to English learner programs must have adequate documentation to support all costs, however, it does not indicate that it has revised its documentation policy.

Long Beach's Action: Partial corrective action taken (one-year response as of October 2006).

Long Beach says that its Office of Program Assistance for Language Minority Students requires all school sites to submit strategic plans listing the activities, supplemental materials, and personnel related to allocated categorical funds. School sites are not allowed to rollover a previous year's plan. The Office of Program Assistance for Language Minority Students approves the strategic plans and all related expenditures.

Los Angeles' Action: Partial corrective action taken (one-year response as of June 2006).

Los Angeles indicates that it is conducting periodic Administrative Academy and other training using revised materials that emphasize district documentation policies and English learner program guidelines. It also says that it revisited its Coordinated Compliance Self-Review process to improve the procedures for analyzing school level English learner program expenditures and verifying supporting documentation. Los Angeles also sent a memorandum regarding ELAP, which included budget guidelines and payroll documentation procedures, to its administrators and administrative staff. The district says it reissued its Program and Budget Handbook in spring 2006 after reviewing the document to assure that documentation policies were clearly stated.

Pajaro's Action: Partial corrective action taken (one-year response as of December 2006).

Pajaro says that in September 2006 it provided follow-up training to principals on allowable expenditures of Impact Aid, Title III, and ELAP funds. In addition, the Director of Federal and State Programs now approves all ELAP expenditures.

Sacramento's Action: Partial corrective action taken (six-month response as of January 2006; no one-year response provided).

Sacramento said that it confirms the correct allocation of bilingual program funds during annual meetings with school sites. It states that it will ensure that it documents the results of these reviews, which can then be agreed to related expenditure files.

San Diego's Action: None (one-year response as of October 2006).

San Diego says that site administrators must approve all expenditures and that a budget analyst monitors expenditures from the central office. San Diego noted that the department's compliance review training guide does not require a documentation trail. San Diego did not indicate it has taken any steps itself to improve documentation.

San Francisco's Action: Partial corrective action taken (one-year response as of December 2006).

San Francisco indicated that the executive director of its Multilingual Programs unit has been meeting with account clerks and relevant administrators to ensure that proper documentation is maintained.

Stockton's Action: Partial corrective action taken (six-month response as of November 2005; no one-year response provided).



Stockton indicates that it has established a new database system to document expenditures for programs, training, and materials for English learners, but it does not say whether it has implemented policies to ensure that expenditure files clearly demonstrate that funds are directed at activities that serve the law's target populations.

Finding #5: The department measures English learner progress in language proficiency and academics, but its evaluation of the contribution of specific English learner programs is weak.

In accordance with federal law, the department has defined annual objectives to measure school districts' success in increasing the percentage of English learners who develop and attain English proficiency. However, school districts inconsistently define their English learner populations, so it is difficult to compare one district's success to another's in meeting the targets for one of the annual objectives. Moreover, state law does not require program-specific evaluations of Impact Aid, and a recent independent evaluation of school districts' implementation of ELAP has not provided conclusive evidence or reliable data on ELAP's effectiveness. Without dependable program-specific evaluations, the State cannot isolate and measure the effectiveness of particular English learner programs.

State law required the department to hire independent evaluators to conduct a five-year study on the impact of Proposition 227 and to evaluate ELAP. However, the evaluators have been unable to reach decisive conclusions on the program's value, in part because school districts combine ELAP with other funding sources to pay for a variety of English learner services and because student performance results are not comparable across school districts. Although the evaluators have not been able to provide decisive conclusions, they have provided meaningful insight and several recommendations regarding ELAP based on school districts' responses to a survey.

We recommended that the department review the evaluators' recommendations, subsequent to the submission of the final report in October 2005, and take necessary actions to implement those recommendations it identifies as having merit to ensure that the State benefits from recommendations in reports on the effects of the implementation of Proposition 227 and ELAP.

Department's Action: Partial corrective action taken (one-year response as of August 2006).

The department says that it is taking necessary actions to implement the six recommendations from the final report that it believes have merit. With regard to a recommendation to specify clear performance standards for key statewide measures for English learner progress and achievement, it indicates that the State Board of Education will review redesignation guidelines to conform with new CELDT proficiency level minimums for the separate listening and speaking scores.

Finding #6: Funding formulas are generally equitable, but a poverty statistic for impact aid needs updating.

Although the department's formulas for distributing English learner program funds are generally sound, the funding formula for Impact Aid is complicated and likely outdated. The Legislative Analyst's Office (legislative analyst) has observed that the complexity of the Impact Aid formula results in district allocations that are hard to understand based on underlying school district demographics and that the formula is weighted heavily toward poverty. Further, a key statistic used in the formula, the number of students in families receiving assistance under the California Work Opportunity and Responsibility to Kids (CalWORKs) program, has become less reflective of the population of students in poverty and is currently unavailable to the department. The governor vetoed a bill redirecting funds to study the Impact Aid formula, instead directing the Department of Finance and the Secretary of Education to work with the legislative analyst and the department to develop options for restructuring the formula. The department indicates that it will collaborate to develop a long-term solution for allocating Impact Aid funds, including determining an appropriate replacement for the CalWORKs data.

We recommended the department continue to work with the Department of Finance, the legislative analyst, and the Legislature to revise the Impact Aid funding formula to include statistics that better measure the number of students in poverty.

Department's Action: Corrective action taken (one-year response as of August 2006).

Assembly Bill 1802, approved by the governor in July 2006, repealed and replaced the existing provisions regarding the calculation and allocation of economic impact aid. Economically disadvantaged pupils, English learner counts, and 2005–06 levels of Economic Impact Aid are major factors in determining funds under the revised formula.

LOS ANGELES DEPARTMENT OF WATER AND POWER

Its Transfers of Funds to the City Comply With the City Charter; However, It Needs to Improve Its Controls Over Contracts, Expenditures, and Personnel Records

Audit Highlights . . .

Our review of certain aspects of the operations of the Los Angeles Department of Water and Power (department) revealed the following:

- The department followed the requirements of the City Charter of the city of Los Angeles (city) and the terms and conditions of its bond debt when it transferred more than \$82 million from its water fund and almost \$575 million from its power fund to the city's reserve fund since fiscal year 2001–02.*
- The department did not always award contracts in compliance with city and department competitive bidding requirements, ensure that staff signed contracts only when authorized, and did not always seek required approvals from the Board of Water and Power Commissioners.*

continued on next page . . .

REPORT NUMBER 2004-130, JANUARY 2005

Los Angeles Department of Water and Power's response as of January 2006

The Joint Legislative Audit Committee requested that the Bureau of State Audits (bureau) review certain aspects of the Department of Water and Power's (department) operations. Specifically, the audit committee requested that the bureau review how and when the department transfers money from its water fund and power fund to the city as well as the department's policies and procedures regarding expenditures, contracting, and personnel practices.

Finding #1: The department followed the requirements of the city charter when it transferred money to the city's reserve fund.

The Los Angeles City Charter (city charter) authorizes the department to transfer surplus money from the Water Revenue Fund (water fund) and the Power Revenue Fund (power fund) to the city of Los Angeles' (city) reserve fund. Although the Board of Water and Power Commissioners' (board) resolutions currently identify the targeted annual transfers as 5 percent of the gross revenue from the water fund and 7 percent of the gross revenue from the power fund, these transfers are potentially limited by provisions in the department's bonds. Under the bonds' provisions, transfers may not exceed the prior year's net income and remaining equity must meet specified equity-to-debt ratios. Our review found that the department followed the requirements of the city charter and the terms and conditions of its bond debt when it transferred a total of \$82.4 million from the water fund and \$574.7 million from the power fund to the city's reserve fund since fiscal year 2001–02.

The department is not unique in transferring money from its water fund and power fund to the city each year. According to a June 2003 presentation of financial information for 38 electric power utilities compiled by Fitch Ratings, a financial research and debt rating company,

- ☑ *In a November 2004 report, the department's internal auditor reported that the department's administration of a series of contracts and purchase orders for the implementation of an automated supply chain management project, valued at more than \$9.7 million, was materially flawed.*
 - ☑ *The department did not ensure that only authorized employees approved invoices for payment.*
 - ☑ *The department did not use available information to consistently assess compliance with, or ensure uniform enforcement of, policies regarding the city's purchasing card program—a program that uses credit cards issued by a commercial bank to provide a cost-efficient procurement process.*
 - ☑ *The lack of central control over the department's personnel files has reduced its ability to ensure that it adequately maintains personnel files that contain the records necessary to support and explain hiring and promotion decisions.*
 - ☑ *The individuals who occupy seven of the exempt positions we reviewed carry job titles and perform duties that are different from those approved by the mayor and city council.*
-

32 (84 percent) of the utilities studied transfer an average of 5.82 percent of their annual revenues to city general funds. The department's annual transfers are close to this average.

We made no recommendation to the department regarding this finding.

Finding #2: The department's Corporate Purchasing Services (CPS) did not always follow its own and the city's policies for competitively bidding contracts for goods and services.

The department's CPS is responsible for processing contracts and purchase orders in compliance with city and department rules. However, CPS did not award contracts in compliance with city and department competitive bidding requirements for two of the 12 contracts we reviewed. The larger of the two contracts was the third of three consecutive contracts awarded to the same vendor for graphic art and design services, valued at \$149,500 each. CPS sought competitive bids for the first of the three contracts but issued the other two contracts to the vendor without seeking competition. The combined total of the three contracts is \$448,500. The department's contract manual states that most expert services usually can be performed by more than one vendor and should be awarded via competitive bid. In addition, the city's administrative code requires the department to seek competitive bids when practicable. However, the city's administrative code also exempts certain personal services contracts that are less than \$2 million from that requirement. Nonetheless, the department's policy still urges competitive bidding. Because CPS did not adequately explain why obtaining competitive bids for the contract was not in the city's interests, we believe CPS should have followed its policy and sought bids for the latest contract and the one preceding it.

In addition, the CPS staff member who executed the contract was not authorized to do so. The contract we reviewed was valued at \$149,500. However, the CPS staff member who signed the contract had authority at that time to sign contracts only up to \$50,000 in value.

We recommended that to ensure the department receives high-quality services and materials at the best available prices, CPS should comply with department and city competitive bidding policies when awarding contracts for goods or services. In addition, CPS should ensure that its staff members sign contracts that obligate the department only when they are authorized to do so.

Department's Action: Corrective action taken.

The department states that it continues to comply with the city charter, city administrative code, department, and city competitive bidding policies when awarding contracts for goods and services. In addition, the board stated it has developed new policies and mandates to increase competitive bidding. The department further states that CPS' signature authorities are reviewed annually and the general manager has rescinded signature authorities for contracts over \$100,000.

Finding #3: CPS awarded contracts for goods and services without obtaining required approvals.

CPS does not always obtain approvals for the contracts it awards. For the graphic art and design services contract valued at \$149,500 previously discussed and five other contracts valued at \$150,000 each, CPS violated board policy because these contracts extended the value of the original contracts beyond the threshold set by board resolution without receiving its approval. By not seeking board approval for contracts when required, CPS cannot ensure that it adheres to the board's control over the department's contracts.

We recommended that CPS recognize when the contracts it awards are extensions of existing contracts and seek board approval when the amended amount exceeds the threshold contained in the department's policy for obtaining such approval.

Department's Action: Partial corrective action taken.

The department states that at the direction of the general manager, the department is currently reviewing a supply management system that includes the ability to track contracts. Pending the system's implementation, the department stated that it is taking the following actions: (1) disseminated a general manager bulletin for department-wide release addressing contracts and (2) the Purchasing, Affirmative Action Outreach Committee oversees approval of all contracts and acts as gatekeeper for all formal contract requests. The department stated that it is also working with other city departments regarding their existing systems.

Finding #4: The department's internal auditor identified several issues related to its administration of a series of contracts.

A November 2004 report prepared by the department's internal auditor contained a finding that the department's administration of a series of contracts and purchase orders for the implementation of an automated supply chain management project, valued at more than \$9.7 million, was materially flawed. Before the system was completed, the vendor abandoned the project and turned off the system. Some of the internal auditor's findings included the following:

- The department had not sought competitive bids for any of the purchase orders or contracts it awarded to the vendor.
- The department's payments on one of the contracts and an amendment exceeded their combined value by almost \$150,000.

- The department had yet to recover the unused portion of the \$275,000 it prepaid for maintenance fees.
- The department had yet to recover two servers from the vendor's premises, costing more than \$13,000, which it purchased to support the system.

To improve its controls over the contracts awarded for goods and services, we recommended CPS promptly implement the recommendations presented in the department's internal auditor's November 2004 report.

Department's Action: Partial corrective action taken.

The department states that CPS is in the process of implementing eight of the 11 internal auditor's recommendations listed in the November 2004 report. With regard to the remaining three recommendations, the department stated that due to current litigation, it is working with the City Attorney's Office as to the appropriate manner of implementation.

Finding #5: The Accounts Payables Unit (accounts payable) does not ensure that expenditures are authorized properly.

The department's accounts payable is responsible for overseeing payments to suppliers. However, although made for appropriate purposes, for 16 of the 45 payments we reviewed (36 percent), accounts payable audit clerks did not ensure that only authorized employees approved invoices for payment.

In order to ensure that the department processes payments correctly and to ensure that payments are made only for authorized purposes, we recommended accounts payable strengthen its internal control procedures to include a process for verifying that contract administrators at the business unit level review and authorize invoices before approving them for payment.

Department's Action: Corrective action taken.

The department states that accounts payable implemented a new payment process incorporating signatory review as of March 1, 2005.

Finding #6: CPS does not oversee the purchasing card program adequately.

The city initiated the purchasing card (P-card) program—a program that uses credit cards issued by a commercial bank—to provide a cost-efficient procurement process for city employees. CPS is responsible for administering the department's participation in the city's P-card program. However, CPS has not implemented procedures to use available information on violations of P-card program policies, such as the results of CPS audits of cardholders' purchases and business unit staff reports of P-card policy violations. Such procedures would enable CPS to consistently assess compliance with, or ensure uniform enforcement of, P-card program policies. These policies restrict the uses for the P-cards, including prohibiting the purchase of certain types of items. They also set daily and monthly dollar limits on purchases and require business unit staff to review purchases to ensure they are authorized and approved. In addition, CPS has not provided clear guidance to the department's business unit

managers for determining the appropriate corrective action business units should take against P-cards in response to P-card policy violations and clear criteria for determining when it would be appropriate to restrict, suspend, cancel, or deactivate P-cards.

We recommended that to strengthen the oversight over the P-card program and to obtain the information needed to evaluate the costs and benefits of the program and minimize abuses, CPS should:

- Collect and use the information that results from CPS audits of cardholders' purchases and business unit staff reports of P-card policy violations to track violations on an ongoing basis, including repeat violations of P-card policy.
- Track and follow up business unit managers' responses to reports of suspected P-card policy violations that result from CPS audits of cardholders' purchases to ensure that the corrective actions business unit managers take against P-cards are effective and that policies are enforced consistently.
- Provide clear guidance for determining the appropriate corrective action business units should take against P-cards in response to violations and clear criteria for determining when it would be appropriate to restrict, suspend, cancel, or deactivate a P-card. Further, CPS should ensure the uniform enforcement of such policies through its improved monitoring efforts.
- Develop criteria or a process to deactivate long inactive P-cards to reduce the risk of inappropriate use and to ensure that access to P-cards is secure.
- Use the information and data available, such as transaction data, compliance data, and activity data, to establish goals for minimizing the rates of policy violations for the P-card program on an ongoing basis.

Department's Action: Partial corrective action taken.

The department states that CPS continues to work with the financial institution that issues the P-cards to have automated reports that will facilitate tracking violations, however, the financial institution's upgrade of the software has been delayed until November 2006. In addition, requests for resources for fiscal year 2005–06 were not approved due to departmental budget constraints.

The department stated it reviewed its policies and processes for possible improvements and implementation, and CPS will continue to track P-card violations on a limited basis and inform business unit managers of these violations. CPS will continue to ensure that employees who are assigned P-cards sign and adhere to the Purchasing Card Employee Acknowledgement of Responsibilities. CPS continues to provide training to new P-card holders regarding the appropriate use of the P-card.

The department stated that CPS reviewed its policy and is developing criteria necessary to review and deactivate long inactive P-cards with input from business units and the controller's office. CPS will submit its policy to deactivate P-cards to executive management for approval.

The department also stated that CPS is using information and data available to establish goals for minimizing the rates of policy violations for the P-card program on an ongoing basis. An additional exception report was added by CPS staff to use in the review of cardholders' transactions to partially comply with the recommendation.

Finding #7: Decentralized responsibility for maintenance personnel files reduces comprehensive personnel record keeping and oversight of positions.

The department's lack of central control over personnel files has reduced its ability to ensure that it adequately maintains personnel files that contain the records required by department policy. For example, department policy requires that documents that support and explain civil service hiring and promotion decisions be kept in these files. These documents are an important element of resolving discrimination complaints that may arise against the department over its hiring or promotion practices. Each business unit, which may be located away from the department's headquarters, maintains personnel files for its employees. However, the business units do not always ensure that these files are complete. As a result, the department could not produce the documents necessary to support and explain its hiring and promotion decisions for four of the 12 civil service appointments we reviewed. In addition, the department's personnel files did not contain evidence that the employees who occupied nine of the department's exempt positions possess the qualifications the department used to justify exempting these positions from civil service regulations. Further, according to research conducted by the department's human resources director for seven of the exempt positions we reviewed, the individuals who occupy them carry job titles and perform duties that are different from the job titles and duties approved by the mayor and the city council for these positions. By not using these positions as approved, the department reduces the city's control over the department's exempt positions and reduces the transparency to the public of its hiring decisions for exempt employees.

To ensure that it adheres to its policies for a single comprehensive record for employees' work history and uniform filing and file retention of employee personnel records, we recommended the department consider changing the decentralized nature of its personnel record keeping and establish a centralized system, administered and maintained under the supervision of the department's director of human resources. In addition, the department should seek approval from the mayor and city council when it uses its exempt positions for duties other than those previously approved by the city.

Department's Action: Partial corrective action taken.

The department states it is in the process of centralizing all employee folders. Exempt folders were compiled in February 2005, and the department anticipates centralizing all employee folders by June 2006.

The department will seek approval of exempt positions not currently approved by the city council once it completes an evaluation of its organizational structure. The general manager has undertaken such an evaluation and anticipates completing it by March 2006.

CALIFORNIA DEPARTMENT OF TRANSPORTATION

Although Encouraging Contractors to Use Recycled Materials in Its Highway Projects, Caltrans Collects Scant Data on Its Recycling and Solid Waste Diversion Efforts

Audit Highlights . . .

Our review of the California Department of Transportation's (Caltrans) use of recycled aggregate in its highway construction projects found that:

- Although Caltrans does not generally see any impediments to using recycled aggregate in its construction projects and allows its contractors to use up to 100 percent recycled materials, it allows contractors to decide when and to what extent recycled aggregate is more cost-effective than virgin aggregate.***
- With no statutory requirement to report how much recycled aggregate is used, Caltrans does not collect this data and thus does not know how much recycled materials its contractors use in highway construction projects.***
- To demonstrate compliance with 1999 legislation, Caltrans captures and reports some data on how much waste construction material its contractors generate for highway construction projects and divert away from landfills.***

continued on next page . . .

REPORT NUMBER 2005-135, JULY 2006

California Department of Transportation's response as of September 2006

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to evaluate the California Department of Transportation's (Caltrans) compliance with the California Public Resources Code, Section 42701, which requires it to write contracts so construction contractors can use recycled materials, unless its director determines that using such materials is not cost-effective. The audit committee also asked us to assess the process Caltrans uses to determine the cost-effectiveness of using recycled materials. Further, we were asked to identify any impediments to Caltrans' use of recycled aggregate material. In addition, the audit committee asked the bureau to determine the extent to which Caltrans communicates the State's recycling requirements to its contractors and encourages them to use recycled materials in its construction projects. Lastly, the audit committee asked us to determine whether Caltrans maintains data on how much recycled aggregate base material its contractors use. If Caltrans does not track this information, the committee asked the bureau to identify, to the extent feasible and using available data, the amount of recycled material used by a sample of Caltrans' geographically diverse road construction and repair projects, both small and large, over the last five years.

Finding #1: Neither Caltrans nor the Public Resources Code requires contractors to report how much recycled aggregate they use in highway construction projects.

Although it encourages contractors to use recycled aggregate in its construction projects, Caltrans does not track how much recycled material contractors actually use for highway construction. Caltrans gives contractors the option to use up to 100 percent recycled aggregate and does not generally perceive any impediments to using such material as long as it meets Caltrans' established standards. However, contractors do not report data on how much recycled aggregate they actually use in highway projects, because statutes do not require and Caltrans does

☑ *Caltrans did not report the solid waste generated on all its construction projects and often could not support the data it did report.*

not ask contractors to submit such information. As a result, Caltrans lacks complete data on how much recycled aggregate contractors use. Nevertheless, to comply with statutes requiring it to limit the solid waste disposed of in landfills, Caltrans does collect some data on the amount of highway construction waste, primarily asphalt and concrete, its contractors recycle.

Finding #2: Caltrans cannot demonstrate that it is meeting the State's goals for diverting solid waste.

Caltrans cannot be sure that it is meeting state goals for diverting solid waste from landfills, because the data it collects and reports to the California Integrated Waste Management Board (board) are incomplete and unsupported. Our review of Caltrans' annual reports on its efforts to divert construction waste materials found that between January 2002 and December 2004 the reports accounted for only a few of the several hundred projects that were active during those years. Although based on more projects than in prior years, Caltrans' 2005 reports to the board contained data for only 14 percent of the projects that should have been included in those reports. Also, the annual reports' project data—collected from the Solid Waste Disposal and Recycling Reports (diversion forms)—are not reliable. In particular, 24 of the 28 diversion forms that were available to us, out of our sample of 30 contracts, contained obvious errors or were not signed by resident engineers. Taking into account these omissions and errors, it is unclear whether Caltrans is meeting state goals for diverting at least 50 percent of its solid waste from landfills.

To ensure that its annual waste management reports to the board are complete and supported, we recommended that Caltrans ensure that its contractors for all projects annually submit diversion forms to the projects' resident engineers in a timely fashion and that its resident engineers submit a copy of all reviewed diversion forms to the appropriate recycling coordinator in a timely fashion. In addition, we recommended that Caltrans ensure that its resident engineers consistently review and sign all diversion forms and consistently follow up with contractors to resolve any discrepancies in material type or volume.

Caltrans' Action: Pending.

Caltrans reported that it is currently writing draft procedures for the district recycling coordinators, to guide them through the process of reviewing the recycling forms submitted by contractors. In addition, Caltrans indicated that it is updating its construction manual and revising the recycling form to include the filing date requirement. Once the procedures and form are revised, Caltrans plans to train its resident engineers on the updated procedures and required review of the revised form. Further, after completing the above, Caltrans noted that it will perform an evaluation to see if its data collection has improved.

OFF-HIGHWAY MOTOR VEHICLE RECREATION PROGRAM

The Lack of a Shared Vision and Questionable Use of Program Funds Limit Its Effectiveness

Audit Highlights . . .

Our review of the Off-Highway Motor Vehicle Recreation Program (OHV program) revealed that:

- The Off-Highway Motor Vehicle Recreation Commission (commission) and the Off-Highway Motor Vehicle Recreation Division (division) have not developed a shared vision to implement an OHV program that is balanced between OHV recreation and the environment.***
- The division's recent strategic plan is incomplete and does not include some important elements such as a comprehensive evaluation of the external and internal factors that could affect the OHV program.***
- In the absence of a formally adopted strategy, the commissioners voted to approve grants and cooperative agreements based on their individual interests rather than on a strategy to achieve a balanced program.***

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REPORT NUMBER 2004-126, AUGUST 2005

Department of Parks and Recreation, Off-Highway Motor Vehicle Division, and Off-Highway Motor Vehicle Commission combined response as of August 2006

The Joint Legislative Audit Committee requested that we review the Department of Parks and Recreation's (department) administration and allocation of moneys in the Off-Highway Vehicle Trust Fund (OHV trust fund).

The Off-Highway Motor Vehicle Recreation Program (OHV program) was created to better manage the growing demand for off-highway vehicle (OHV) recreation while protecting California's natural and cultural resources from the damage that can occur from indiscriminate or uncontrolled OHV recreation. The department's Off-Highway Motor Vehicle Recreation Division (division) administers the OHV program. The division operates eight state vehicular recreation areas (SVRAs) and administers the grants and cooperative agreements program (grants program), which provides funding to local and federal government agencies for OHV recreation.

The OHV program is funded primarily through collection of the fuel tax, registration fees for off-highway vehicles, and SVRA entrance fees. The Off-Highway Motor Vehicle Recreation Commission (commission) provides for public input, offers policy guidance to the division, and approves grants and cooperative agreements. The commission also approves the division's capital outlays. The governor and the Legislature appoint the commissioners, who represent varying interests in OHV recreation and serve staggered four-year terms.

- ☑ *Recent legal requirements to spend designated portions of OHV program revenue for conservation, restoration, and law enforcement have not been met and because the division has not set aside the cash, a growing unfunded obligation exists.*
- ☑ *The division and the Department of Parks and Recreation (department) have spent or earmarked \$38 million for three land acquisition projects—one completed and two under consideration—that offer little or no additional OHV recreation.*
- ☑ *Based on a questionable legal interpretation and inadequately supported cost estimates, the department is using Off-Highway Trust Fund money—\$3.6 million during fiscal year 2003–04—to support state parks that do not have OHV recreation.*
- ☑ *The division made questionable purchases of goods and services using contracts paid with OHV funds and in numerous instances violated state contracting rules.*
- ☑ *The division's management of the funds expended through grants and cooperative agreements needs improvement.*

Finding #1: The commission and the division have not formally adopted a shared vision for the OHV program, nor have they developed the goals and strategies necessary to meet that vision.

The commission and the division have not formally adopted a shared vision for the OHV program to balance OHV recreation and protection of California's natural and cultural resources, nor have they developed the goals and strategies necessary to meet that vision. In addition, the division and the commission do not collaborate on the planning for the SVRAs and grants program. In the absence of a shared vision and goals, the commissioners, the division, and stakeholders in the OHV program compete for the more than \$50 million collected from OHV recreationists each year to serve their diverse interests and further individual agendas, potentially resulting in an inefficient use of funds and discord among the interested parties.

To ensure that the OHV program is adequately balanced between OHV recreation opportunities and environmental concerns as the Legislature intended, we recommended that the division and the commission develop a shared vision that addresses the diverse interests in the OHV program. Once developed, the division and the commission should implement their vision by adopting a strategic plan that identifies common goals for the grants program and the SVRAs, taken as a whole, and specifies the strategies and action plans to meet those goals.

Department's and Commission's Action: Partial corrective action taken.

The department states that the commission discussed and approved a draft shared vision statement for the OHV program in its September 2006 meeting. However, the department indicates that additional information is needed to finalize the shared vision statement, including public comment on it and completion of the fuel tax study, which occurred in December 2006. The department anticipates that the final version of the shared vision statement will be ready for the commission's review at its January 2007 meeting.

Finding #2: Although required by law to do so by January 1, 2005, the division has not yet completed its strategic planning process to identify future OHV recreation needs.

The division prepared a final draft of a strategic plan in March 2005, but it used an abbreviated planning process that did not include some important elements such as a comprehensive evaluation of the external and internal factors that could affect its ability to successfully implement the OHV program. In addition, the commission and the division have not collected the necessary data or prepared the required

reports to successfully complete its strategic planning. For example, the division has begun but has not yet completed a new fuel tax study that will provide information on the number and types of off-highway vehicles engaged in OHV recreation and the destinations and types of recreation sought by OHV enthusiasts. Without a comprehensive strategic plan, the division's budgets are not guided by agreed-upon goals and strategies for achieving them but rather on historical spending levels and available funds.

We recommended the division complete its strategic plan for the SVRA portion of the OHV program by performing a thorough assessment of external and internal factors; collecting the necessary data; completing the required reports; and developing the action, spending, and performance monitoring plans to implement its strategic plan.

Department's and Commission's Action: Partial corrective action taken.

The department reports that the division has been taking steps to develop the final strategic plan. These steps include hiring additional staff to work on it, surveying other states about issues their OHV programs face, and obtaining public input. However, the department states that several activities still need to occur, including developing a formal land acquisition process, assessing best management practices for the SVRA, finalizing new grant procedures and regulations, and completing the fuel tax study, which occurred in December 2006. Therefore, the department anticipates completing the strategic plan for the OHV program by March 2007.

Finding #3: The commission has not formally adopted a strategy for grants program funding.

In the absence of a formally adopted strategy, the grants program lacks direction, and commissioners vote to approve grants and cooperative agreements based on their individual interests. As a result, the applicants for the grants program are often unaware of the commission's priorities, and the funding issued by the grants program is not done to achieve a balanced OHV program. According to the recipients that receive the largest grants and cooperative agreements, unclear guidance on the commission's priorities presents challenges for them when applying for funds from the grants program.

To make efficient use of division staff's time and provide guidance to grants program applicants, we recommended the commission develop and communicate priorities based on a strategy for using the grants program to promote a balanced OHV program.

Commission's Action: Partial corrective action taken.

The department indicates that for the fiscal year 2005–06 grant application cycle, the commission identified, voted, and set priorities for funding that were subsequently communicated to grant applicants. In addition, the division is working with the Office of Administrative Law to obtain approval for the temporary regulations it and the commission used during the fiscal year 2005–06 grant application cycle.

Finding #4: The commission's accountability for its funding decisions could be improved.

The law currently requires the commission to provide a biennial report on certain elements of the OHV program, including the status of the program and its natural and cultural resources and the results of the division's strategic planning process. However, the law does not require the commission to report its strategies and priorities, and how it awards OHV trust fund money to meet the legislative intent of the OHV program. In addition, the commission has not yet prepared the biennial report that was due to the Legislature on July 1, 2005.

To improve accountability, we recommended the Legislature consider amending state law to require the commission to annually report the grants and cooperative agreements it awards by recipient and project category, and how the awards work to achieve the shared vision that it and the division develop. We also recommended that the commission prepare and submit the required biennial program reports when they are due.

Commission's Action: Pending.

➔ The department states the commission's biennial program report has not been completed as of December 2006, but it expects to complete a draft for the commission's review in spring 2007.

Legislative Action: None.

Finding #5: Some spending requirements in the law may impede the ability of the commission and the division to implement a vision for the OHV program.

Based on a stakeholders' consensus reached in 2002 that was adopted into the law, the division is required to spend the portion of fuel tax revenue attributable to unregistered off-highway vehicles and deposited in the Conservation and Enforcement Services Account (conservation account) for restoration, conservation, and enforcement activities. That portion was \$28.4 million, or 61 percent, of the OHV program's fiscal year 2003-04 revenues. However, there is disagreement among the commission, the division, and the stakeholders about whether this spending requirement contributes to a balanced OHV program. Further, because the division has not been able to satisfy the spending requirement, since January 2003 it has accumulated an obligation to use unspent conservation account funds of \$15.7 million, including \$8.3 million designated for restoration activities. The department indicates the unspent cash to pay for this future obligation is not reserved; thus, it may present a substantial financial burden.

We recommended that the division and commission evaluate the current spending restrictions in the law to determine whether they allow for the allocation of funds necessary to provide a balanced OHV program and, if necessary, seek legislation to adjust those restrictions.

Department's and Commission's Action: Pending.

The department states that the division is working with consultants to better assess the OHV program's funding needs. However, to complete this assessment, the division is waiting for the completion of the fuel tax study, which was released in December 2006, and the OHV program strategic plan, which it believes will be completed in March 2007.

Finding #6: The law is not clear on the use of restoration funds.

The present practice of the commission and division is to require areas and trails to be permanently closed to OHV recreation before restoration funds are used to repair damage from OHV recreation. However, the law does not support this practice, especially with respect to restoration funds that are used on federal lands. Rather, it states that when soil conservation standards or wildlife habitat protection standards are not being met in any portion of an OHV recreation project area that is supported by a cooperative agreement, the area that is out of compliance must be temporarily closed until those standards are met.

We recommended that the Legislature consider amending the Public Resources Code to clarify whether using OHV trust fund money to restore land damaged by OHV recreation requires that the land be permanently closed to off-highway vehicles.

Legislative Action: None.

Finding #7: The division and the department have used money from the OHV trust fund for questionable purposes with respect to land acquisition.

For three recent land acquisition projects, with planned costs totaling \$38 million, the division and the department could not provide analyses that showed the benefit of these purchases to the OHV program. The division has purchased Deer Creek Hills, and Onyx Ranch and Laborde Canyon are still under consideration. However, based on the available documentation, these projects do not appear to be the best use of the funds in implementing the OHV program. In each case, project land will be devoted largely to protecting or preserving natural or cultural resources with a relatively small portion or no portion at all available for OHV recreation.

We recommended the division develop and implement a process of evaluating land acquisition projects to ensure that they provide a strategic benefit to the OHV program. This process should include appropriate analysis of the costs and benefits of a proposed land acquisition, including an assessment of the need for additional land for OHV recreation.

Department's Action: Pending.

The department states it believes that a comprehensive land acquisition strategy should be linked to the development of the strategic plan; findings from the fuel tax study; and input and collaboration from interested communities, organizations, and stakeholders. Because the fuel tax study was only recently released and the OHV program strategic plan will not be completed until March 2007, the department estimated the earliest date that a comprehensive land acquisition strategy would be completed is March 2007.



Finding #8: The department made questionable and inadequately supported charges to the OHV trust fund to help pay for state park operations and departmental overhead costs.

In fiscal year 2003–04 the department began using the OHV trust fund to pay for some of the costs to operate park districts that are not SVRAs because it interprets the law to mean vehicle use on any unpaved road in the state park system is eligible for OHV program funding. However, we believe the department’s interpretation is inconsistent with the Legislature’s clear intent for the OHV program and with provisions of law that limit the use of the OHV trust fund. These costs, which we found were inadequately supported, totaled \$3.6 million for fiscal year 2003–04 and \$2.7 million during the first three quarters of fiscal year 2004–05. The lack of adequate support for these costs is disconcerting because the department plans to use these costs as a basis for its future charges to the OHV trust fund for these activities. Moreover, because the department allocates its overhead costs based on direct costs to programs, the OHV trust fund was charged an additional \$437,000 in fiscal year 2003–04 alone for the questionable costs we found.

In addition, the department charged approximately \$72,000 of the director’s office costs in fiscal year 2003–04 to the OHV trust fund, even though the law expressly forbids those charges.

To ensure that money from the OHV trust fund is used appropriately, we recommended the Legislature amend the law to clarify the allowable uses of the OHV trust fund. Such clarification should specify whether the department’s broad interpretation that any road that is not defined as a highway but is open for public use in a state park qualifies for funding by the OHV trust fund is correct, or whether state law restricts the use of OHV trust fund money to areas where non-street-licensed vehicles can engage in traditional OHV activity.

We also recommended that the department either discontinue charging the director’s office costs to the OHV trust fund or seek a statutory change to remove this restriction.

Department’s Action: Partial corrective action taken.

Although the department has discontinued charging the director’s office costs to the OHV program, it continues to budget costs of \$3 million annually to the OHV trust fund for the operation of non-SVRA parks. The department states that it holds firm to the position that it has broad discretion when interpreting the law, and thus it believes that using OHV trust funds for the partial support of parks outside of the traditional SVRAs is appropriate given the level of OHV activities occurring in those parks. The department took the same position in its initial response to our audit report, which we disagree with because, while recognizing the department’s broad discretion to interpret the statutes it is charged with carrying out, we believe that in this case the department’s interpretation is so broad that it may be inconsistent with the goals of the statutes governing the OHV program.

Legislative Action: None.

Finding #9: The division's contracting practices often violate state contracting rules, and it has not explored less costly alternatives to these contracts.

For various reasons the division has increased its use of contracts over the past five years, with a peak in contracting occurring in fiscal year 2002–03. However, the division has used contracts paid from the OHV trust fund for questionable purchases and it also violated rules that govern the use of contracts, including 80 instances of splitting a series of related tasks into multiple contracts to avoid competitive bidding and oversight. Further, the division has not adequately analyzed its operations to determine if either using existing staff or hiring additional employees would be less expensive than contracting for staff-related work and ongoing needs. Most of these contracting problems occurred in fiscal years 2001–02 and 2002–03, but some were more recent.

We recommended the division take the following steps:

- Comply with state contracting requirements.
- Contract only for services that are an allowable use of the OHV trust fund and provide a clear value to the OHV program.
- Analyze its operations to determine if using existing staff or hiring additional staff would be a less expensive alternative to contracting for staff-related work and for ongoing needs.

We also recommended that the department increase its oversight of the division's contracting practices.

Department's Action: Implemented.

The department reports that the division now requires the division chief review and approve all headquarters contracts and district superintendents have been counseled and trained on the review and approval of contracts.

The department also states that some work previously performed by contractors has been permanently transferred to state employees. In particular, division staff are now taking an active role in organizing and setting up commission meetings.

The department states that its Contracts Service Unit reviews all small dollar contracts to ensure compliance with state contracting requirements and alerts the appropriate managers should it identify multiple small contracts to the same vendor.

Finding #10: Administration of the grants program lacks accountability.

The division needs to better track funds it advances to grantees to ensure that advanced funds are used only for allowable activities and that unused funds are returned. Specifically, we identified \$881,000 in outstanding advances, including \$566,000 advanced to Los Angeles County, which were either not returned or that the division had been unable to determine how the funds were spent. In addition, the division does not ensure that all completed grants and cooperative agreements are audited, and in our review of 12 audit reports the division had not collected ineligible costs of \$598,000 related to three audits. The division also circumvented state budget controls and its regulations when it reallocated unspent grant funds totaling \$2.2 million among U.S. Forest

Service districts. Further, the commission and the division sometimes use the OHV grants program to fund questionable activities. Finally, the division's grants database does not meet its information needs and contains numerous errors and inaccuracies that limit its value.

We recommended that the division keep track of funds advanced to recipients, ensure that all grants and cooperative agreements receive annual fiscal audits and performance reviews, follow-up on audit findings and collect ineligible costs, discontinue its practice of reallocating unspent grant funds among Forest Service districts, and improve its grants database. Additionally, we recommended that the commission allocate funds only for purposes that clearly meet the intent of the OHV program.

Department's and Commission's Action: Partial corrective action taken.

The department reports the division is working to implement policies that provide tracking, monitoring, and recovery of OHV program funds. Further, the division is working to recover portions of the grants and cooperative agreements owed to it by the grantees that we identified in our audit. Of the \$566,000 we identified as outstanding from Los Angeles County, the division reports receiving a \$226,000 refund and determining that the remaining \$340,000 was used in accordance with grant guidelines. Of the \$711,000 outstanding from the Bureau of Reclamation, the division reports receiving appropriate supporting documentation for \$611,000, and although it did not receive documentation to support the remaining \$100,000, its research indicates that these funds were used for their intended purposes. In regards to the \$598,000 of ineligible costs that the department's auditors identified on three grants, the division's research indicates that two grants to Sacramento County were used for the intended purposes, and for the third grant, it is verifying that the advances to the Bureau of Land Management were refunded.

The department states that the division is committed to performing site visits and it is developing site review guidelines to include in the OHV program regulations. In addition, the department indicates that the division is working to ensure grants are audited, audit findings promptly scheduled and resolved, and ineligible costs recovered. The department indicates it has halted all reallocations of unspent grant funds among U.S. Forest districts or among other grantees. Also, the department reports the division is working with the department's Information Technology Division to improve the grants database, including development of an online grant application. Finally, the department indicates that the division will follow a competitive process to ensure that funds allocated through grants and cooperative agreements are spent only on projects that meet the intent of the OHV program.

EMERGENCY PREPAREDNESS

More Needs to Be Done to Improve California's Preparedness for Responding to Infectious Disease Emergencies

REPORT NUMBER 2004-133, AUGUST 2005

Audit Highlights . . .

Our review of California's preparedness for responding to an infectious disease emergency revealed the following:

- The Emergency Medical Services Authority has not updated two critical plans: the Disaster Medical Response Plan, last issued in 1992, and the Medical Mutual Aid Plan, last issued in 1974.***
- The Department of Health Services (Health Services) does not have a tracking process for following up on recommendations identified in postexercise evaluations, known as after-action reports.***
- Although Health Services has completed 12 of 14 critical benchmarks it was required to complete by June 2004 for one cooperative agreement, we cannot conclude it completed the other two. In addition, Health Services has been slow in spending the funds for another cooperative agreement.***

continued on next page . . .

Department of Health Services, Emergency Medical Services Authority, and five local public health department's responses as of October 2006¹

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the State's preparedness to respond to an infectious disease emergency requiring a coordinated response between federal agencies, the Department of Health Services (Health Services), local health agencies, and local infectious disease laboratories. Specifically, the audit committee requested that we (1) evaluate whether Health Services' policies and procedures include clear lines of authority, responsibility, and communication between levels of government for activities such as testing, authorizing vaccinations, and quarantine measures; (2) determine whether Health Services has developed an emergency plan; (3) determine whether California's infectious disease laboratories are integrated appropriately into statewide preparedness planning for infectious disease emergencies; (4) determine if the management practices and resources, including equipment and personnel, at the state health laboratories are sufficient to respond to a public health emergency; and (5) review Health Services' standards for providing oversight to local infectious disease laboratories, and determine whether its oversight practices achieved their intended results.

The audit committee further requested that we evaluate whether a sample of local infectious disease laboratories are operated and managed effectively and efficiently and have the necessary resources to respond to an emergency, including sufficient equipment and personnel with the appropriate level of experience and training. We also were asked to review the local laboratories' testing procedures for infectious diseases and determine if they meet applicable standards.

¹ The five local public health departments are: County of Los Angeles, Department of Health Services (Los Angeles); Sacramento County Department of Health and Human Services, Division of Public Health (Sacramento); County of San Bernardino, Department of Public Health (San Bernardino); Santa Clara County, Public Health Department (Santa Clara); Sutter County, Human Services Department (Sutter).

- ☑ *None of the five local public health departments we visited have written procedures for following up on recommendations identified in after-action reports.*
 - ☑ *None of the five local public health departments we visited had fully completed the critical benchmarks for a cooperative agreement by the June 2004 deadline.*
-

Finding #1: The Emergency Medical Services Authority needs to update two critical plans.

The Emergency Medical Services Authority (Medical Services) has not updated two emergency plans: the *Disaster Medical Response Plan* and the *Medical Mutual Aid Plan*, the latest versions of which are dated 1992 and 1974, respectively. The state emergency plan, issued in 1998, mentions both plans and describes them as “under development.”

The state emergency plan indicates that state entities would use the two plans to help respond to emergencies caused by factors that include epidemics, infestation, disease, and terrorist acts, therefore, we believe the two plans are critical for California’s successful response to infectious disease emergencies. Medical Services agrees that the plans must be updated to ensure that they reflect the State’s current policies and account for any changes in roles or responsibilities since they originally were issued. According to the chief of the Medical Services’ Disaster Medical Services Division, these plans have not been updated because Medical Services lacks resources and has competing priorities.

We recommended that Medical Services update the *Disaster Medical Response Plan* and the *Medical Mutual Aid Plan* as soon as resources and priorities allow.

Medical Services’ Action: Pending.

Medical Services stated that it has completed initial drafts of a State Disaster Medical Plan and a Medical Mutual Aid component. As of December 2006, Medical Services was circulating the drafts for review and comment. Medical Services stated that revised drafts will be completed by December 31, 2006, and then forwarded to the Governor’s Office of Emergency Services for its formal review.

Finding #2: Health Services does not have a tracking method to ensure that it benefits from the lessons it learned.

Health Services could improve its ability to learn from its experiences by developing and implementing a tracking process for following up on the recommendations made in its postexercise evaluations, known as after-action reports. According to guidelines developed by the U.S. Department of Homeland Security’s Office for Domestic Preparedness, after-action reports are tools for providing feedback, and entities should establish a tracking process to ensure that improvements recommended in after-action reports are made. Similarly, the National Fire Protection Association also suggests in its Standard on Disaster/Emergency Management and Business Continuity Programs (2004 edition) that exercise participants establish procedures to ensure that they take corrective action on any deficiency identified in the evaluation process, such as revisions to relevant program plans. An exercise allows the participating entities to become familiar, in a nonemergency setting, with the procedures, facilities, and systems they

have for an actual emergency. The resulting after-action reports give these entities an opportunity to identify problems and successes that occurred during the exercise, to take corrective actions, such as revising emergency plans and procedures, and thus benefit from lessons learned from the exercise. Therefore, we believe that tracking the implementation status is a sound practice to ensure that state entities address all relevant recommendations in after-action reports, which can then serve as important tools for increasing overall preparedness levels.

In response to our concerns that Health Services lacked a written policy and procedures for following up on recommendations identified in after-action reports for exercises, the deputy director for public health emergency preparedness provided us on July 14, 2005, with the recently developed policy and procedures. However, our review of the policy found that it does not include a standard format for tracking the implementation of recommendations, such as assigning an individual the responsibility for taking action, the current status of recommendations, and the expected date of completion. Therefore, Health Services still needs to refine its policy further by developing and implementing written tracking procedures to ensure it addresses all relevant recommendations that it identifies in after-action reports. Without a tracking method, Health Services cannot be certain that it takes appropriate and consistent corrective action, such as revising emergency plans, and thus reduces its potential effectiveness to respond to infectious disease emergencies.

We recommended that Health Services develop and implement a tracking method for following up on recommendations identified in after-action reports.

Health Services' Action: Corrective action taken.

Health Services developed and implemented a policy on after-action reporting in response to our draft report on July 25, 2005. This policy and the associated procedures provide a specific tool for tracking recommendations identified in after-action reports.

Finding #3: We cannot conclude that Health Services completed a critical benchmark requiring it to assess its preparedness to respond to infectious disease emergencies.

In the aftermath of the terrorist attacks in September 2001, and the anthrax attacks later that year, two federal agencies—the Centers for Disease Control and Prevention (CDC) and the Health Resources and Services Administration (HRSA)—offered cooperative agreements to states, local jurisdictions, and hospitals and other health care entities. The cooperative agreements are intended to provide increased funding to improve the nation's preparedness for bioterrorist attacks and other types of emergencies, including those caused by infectious diseases. However, despite making progress toward completing many of the critical benchmarks established in the CDC cooperative agreement with a June 2004 deadline, we cannot conclude as of our review that Health Services completed critical benchmark number 3, which requires the State to assess its emergency preparedness and response capabilities related to bioterrorism, other infectious disease outbreaks, and other public health threats and emergencies with a view to facilitating planning and setting implementation priorities. Therefore, California may not be as prepared as it could be to respond to infectious disease emergencies.

According to its deputy director for public health emergency preparedness (Health Services' deputy director), Health Services prepared an assessment as did all local health departments. She also stated that some staff documented parts of their assessment and that Health Services' application

for CDC funding in 2004 included references to the assessments. However, she also acknowledged that Health Services did not prepare a single written summary of the assessment it prepared and the assessments prepared by local health departments. Without such a summary and without complete documentation of the assessments, Health Services has not demonstrated to our satisfaction that it has fully completed critical benchmark number 3. Health Services' deputy director also told us that to obtain a more current assessment, Health Services has entered into a contract with the Health Officers' Association of California (HOAC) to be conducted from mid-2005 through December 2006.

We recommended that Health Services should ensure that the contractor performing the current capacity assessment provides a written report that summarizes the results of its data gathering and analyses and contains applicable findings and recommendations.

Health Services' Action: Pending.

Health Services stated that it has contracted with HOAC for an assessment of public health emergency preparedness in 61 local health departments. Health Services indicated that 39 local assessments have been completed as of July 2006 and all assessments are to be completed by the end of December 2006. Further, it is requiring HOAC to provide written reports that summarize the results of the analyses and contain applicable findings and recommendations for improvements.

Finding #4: Local public health departments could do more to address after-action reports.

Local emergency plans, such as the counties' overall emergency operation plans and local public health departments' (local health department) emergency operations and response plans, generally included sufficient guidance for emergency preparedness; however, the plans did not include specific procedures for following up on recommendations identified in after-action reports. When we asked officials of the local health departments, they agreed with our assessment and confirmed that they did not have written procedures for following up on recommendations in after-action reports although Los Angeles County has developed a draft policy.

Moreover, the California Code of Regulations requires state entities to complete after-action reports for declared emergencies within 90 days of the close of the incident. There is no requirement for preparing after-action reports for an exercise or drill as there is for a declared emergency, but we believe that promptly writing after-action reports for exercises is prudent and equally relevant. Waiting longer than 90 days to complete the reports might make it more difficult for the individuals involved in the exercise to recall specific details accurately. Therefore, we expected all participants in the November 2004 exercise hosted by Medical Services to have prepared after-action reports within 90 days to identify any weaknesses in plans and procedures and to take appropriate corrective actions. However, as of July 2005, the after-action report from Los Angeles County's health department was still in draft stage, which is approximately seven months after the exercise. According to the executive director of the county's Bioterrorism Preparedness Program (executive director), the Los Angeles County health department had not yet implemented all the recommendations identified. The executive director stated that it experienced delays in drafting its after-action report because the individuals who participated in the exercise were inexperienced with the formalized after-action report process and completing the surveys and observations needed. She further stated that several drafts were reviewed and resubmitted by its management. However,

because the Los Angeles County health department did not complete its after-action report promptly, it did not address all the recommendations as quickly as it could have. Consequently, it is not as prepared as it could be to respond to infectious disease emergencies.

We recommended that local health departments establish written procedures for following up on recommendations identified in after-action reports and that they prepare after-action reports within 90 days of an exercise.

Local Public Health Departments' Actions: Partial corrective action taken.

The five local health departments we visited generally indicated that they have developed written procedures for following up on recommendations identified in after-action reports. Also, four of the five local health departments indicated they prepared after-action reports within 90 days. The fifth local health department, Sutter County, did not address this part of the recommendation.

Finding #5: Not all local public health departments have met the deadline to implement several federal benchmarks.

None of the local health departments we visited had met all 14 of the CDC 2002 critical benchmarks by the required deadline of June 2004. Specifically, Los Angeles and Sacramento counties health departments did not meet the June 2004 deadline, but they report that they have since completed the benchmarks. Further, Sutter and Santa Clara counties did not meet one of the 14 2002 critical benchmarks as of June 2005, and San Bernardino County did not meet three. The purpose of the CDC cooperative agreement is, in part, to upgrade local health departments' preparedness for and response to bioterrorism, outbreaks of infectious disease, and other public health threats and emergencies. Therefore, by not meeting the critical benchmarks, these jurisdictions may not be as prepared as possible to respond to an infectious disease emergency.

We recommended that local health departments complete the critical benchmarks set by the CDC cooperative agreement as soon as possible.

Local Public Health Departments' Actions: Partial corrective action taken.

Los Angeles and Sacramento counties' health departments reported that they had completed the critical benchmarks. Additionally, Santa Clara now reports that it has completed its last benchmark while San Bernardino reports completing two of three outstanding benchmarks. Finally, Sutter County indicated that it is still working to complete critical benchmarks.

DEPARTMENT OF HEALTH SERVICES

Investigations of Improper Activities by State Employees, July 2004 Through December 2004

INVESTIGATION I2003-1067 (REPORT I2005-1), MARCH 2005

Department of Health Services' response as of February 2006

Investigative Highlights . . .

An employee with the Department of Health Services:

- Falsely indicated on at least 22 occasions that she was working in order to receive \$1,894 in wages and overtime she was not entitled to receive.*
 - Claimed and was paid \$1,173 for expenses related to her travel that she either did not incur or was not entitled to receive.*
-

We investigated and substantiated an allegation that an employee of the Department of Health Services (Health Services) submitted false travel and attendance reports.

Finding: *The employee submitted false travel and attendance reports in order to receive wages and travel expenses she was not entitled to receive.*

The employee, whose duties require her to travel regularly throughout the State to monitor and provide training to retail businesses, improperly received \$3,067 by submitting false claims for wages and travel costs. We determined that, by misrepresenting her departure and return times on her travel and attendance reports, the employee was paid \$1,894 for overtime and regular hours she did not work. We also found that the employee claimed and was paid \$1,173 for expenses related to her travel that she either did not incur or was not entitled to receive. Specifically, the employee claimed \$253 for parking expenses that she acknowledged to us she did not incur. The employee also improperly claimed \$151 in mileage reimbursements by routinely overstating the distance to and from the airport when conducting state business. Because the employee presented false information on her travel claims, she also received \$259 for meal expenses that she was not entitled to receive. Finally, the employee improperly received \$510 for travel expenses that she claimed on days she did not work or that otherwise were not allowed.

Health Services' Action: Corrective action taken.

Health Services provided training to all its supervisors in the employee's branch so they can better understand their responsibilities for reviewing travel claims and overtime requests submitted by those under their supervision. Those working in the employee's branch will also begin using the State's automated travel claim processing system (system). Because the business rules for travel are programmed into the system, Health Services believes the submission of improper travel claims will be reduced.

Finally, Health Services reduced the employee's pay by 5 percent for three months for inexcusable neglect of duty, dishonesty, and willful disobedience. Health Services reassigned the employee into a position with no travel responsibilities and required her to reimburse Health Services \$943 for her improper parking expenses, excessive mileage claimed, and other improper expenses the employee claimed.

BATTERER INTERVENTION PROGRAMS

County Probation Departments Could Improve Their Compliance With State Law, but Progress in Batterer Accountability Also Depends on the Courts

REPORT NUMBER 2005-130, NOVEMBER 2006

Audit Highlights . . .

Our review of batterer intervention programs (programs) in California revealed the following:

- Only about half of batterers complete a program as required by state law.*
- Only two batterers in our sample of 125 ever completed a program after committing three or more violations of their program or probation terms.*
- The county probation departments (departments) we visited had various attendance policies, and all were more lenient than statutory provisions, which allow for only three absences for good cause.*
- Rather than notifying the courts as required by state law, some departments are counseling and referring batterers back to programs after they have been terminated for violations.*

continued on next page . . .

Five county probation departments' responses as of November 2006

State law requires an individual who is placed on probation for a crime of domestic violence to complete a 52-week batterer intervention program (program) approved by a county probation department (department). The programs are structured courses designed to stop the use of physical, psychological, or sexual abuse to gain or maintain control over a person such as a spouse or cohabitant. The Joint Legislative Audit Committee requested that the Bureau of State Audits examine the extent to which the various entities involved in batterer intervention—including programs, departments, and courts—hold convicted batterers accountable. Specifically, we were asked to review how the departments and courts responded to a sample of progress reports, allegations, or other information from the programs. We were also asked to determine how well a sample of departments oversee programs.

Finding #1: Many batterers do not complete their required programs, and the extent to which they are held accountable varies.

Based on statistics provided by the departments and our review of a sample of 125 batterers, only about half of the batterers required to complete a program actually do so. In reviewing department responses to violations committed by the 125 batterers, we found that some departments we visited counseled and referred batterers back to programs after they had been terminated for violations, rather than notifying the courts as required by state law. Because only two batterers in our sample ever completed a program after committing three or more violations, we questioned whether this practice only delays the inevitable court-imposed consequences of jail time or probation revocation. Further, some courts notified of violations simply returned batterers to programs without imposing any additional jail time, even though at times the batterer had multiple prior violations. We questioned whether this practice may be sending the unintentional message to batterers that they can avoid the program requirement without any significant penalty for doing so.

- ☑ *Courts sometimes do not impose any consequences on batterers, even those with multiple prior violations.*
 - ☑ *On-site program reviews required by statute are not being performed consistently.*
-

Although the most frequent violation involved noncompliance with attendance policies, the departments we reviewed had various policies regarding program attendance, and all were more lenient than statutory provisions, which allow for only three absences for good cause. In discussing their policies, departments cited the need for greater flexibility in attendance policies to allow as many batterers as possible to complete their assigned programs. In addition, the counties of some of the departments we visited have implemented a practice of having batterers make regular appearances to have their progress reviewed by the court. This appears to provide for better batterer accountability and may improve program outcomes.

We recommended that the departments, in conjunction with the courts and other interested county entities, jointly consider taking the following actions:

- Establish and clearly notify batterers of a set of graduated consequences that specify minimum penalties for violations of program requirements or probation terms. The nature of the violation, as well as the number of previous violations, should be taken into consideration when establishing the consequences.
- As part of these graduated consequences, establish a limit to the number of violations they allow before a batterer's probation is revoked and he or she is sentenced to jail or prison.
- Eliminate the practice of having probation officers counsel and direct batterers back to programs in which they failed to enroll or from which they have been terminated for excessive absences, and establish a consistent practice of notifying the court of such violations, allowing the court to set the consequence for the violations.
- If they have not already done so, implement a practice of regular court appearances in which batterers receive both negative and positive feedback on program compliance.
- Require programs to submit progress reports to the courts at the frequency specified by law.

We also recommended that the Legislature consider revising the attendance provisions included in the law to more closely align with what departments and courts indicate is a more reasonable standard.

Butte County Probation Department's Action: Pending.

The Butte department indicated that it plans to implement the report's recommendations.

Los Angeles County Probation Department's Action: None.

The department in Los Angeles County, in consultation with the court in the county, indicated that it believes some of the recommendations interfere with the discretion of individual judges.

Riverside County Probation Department's Action: Pending.

The Riverside department indicated that it needs time to consult with the court and that it will provide a response at a later date.

San Joaquin County Probation Department's Action: Pending.

The department in San Joaquin County indicated that it plans to develop a set of graduated consequences but, because of jail overcrowding, does not believe setting a limit to the number of violations will improve batterer accountability in San Joaquin County. It also indicated that the court will bestow authority on the department to direct batterers to reenroll in a program after they are terminated from a program for their first probation violation and then the department will notify the courts of all subsequent violations.

The department indicated that it agrees with the concept of regular court appearances, but because of limited resources, it would not be feasible to implement this recommendation at this time.

San Mateo County Probation Department's Action: Pending.

The San Mateo department raised some concerns with the recommendations but did not specifically address whether it would be implementing them.

Legislative Action: Unknown.

Finding #2: Some courts appear to be inappropriately sentencing batterers to anger management programs that do not last 52 weeks and may not address domestic violence issues.

During the course of our audit, department officials told us, and evidence we found at one county we visited confirmed, that courts were directing individuals placed on probation for crimes of domestic violence to 16-week anger management programs, rather than the required 52-week batterer intervention programs. We also found one instance in Los Angeles County where the court delayed sentencing on an individual it found guilty of battery (the victim met the statutory definition of domestic violence contained in Family Code 6211) until 26 court-ordered program sessions could be completed. Then, after six months of delayed sentencing, it dismissed the charges "in the furtherance of justice."

We recommended that the courts consistently sentence, and the departments consistently direct, individuals granted probation for a crime of domestic violence—when the victim is a person specified in Section 6211 of the Family Code—to a 52-week batterer intervention program approved by the department. Courts should not substitute any other type of program, such as a 16-week anger management program, for a 52-week batterer intervention program.

If it is the Legislature's intent that individuals who commit domestic violence be consistently sentenced to 52 weeks of batterer intervention, it should consider enacting statutory provisions that would not allow the courts to delay sentencing so that batterers can complete a lesser number of program sessions.

Los Angeles County Probation Department's Action: Pending.

- The department in Los Angeles County did not specifically address the above recommendation.

Riverside County Probation Department's Action: Pending.

The Riverside department indicated that it needs time to consult with the court and that it will provide a response at a later date.

San Joaquin County Probation Department's Action: Pending.

- The department in San Joaquin County did not specifically address the above recommendation.

Legislative Action: Unknown.

Finding #3: County probation departments could improve their monitoring of programs by more closely adhering to state law and by implementing performance measures.

Although state law requires departments to design and implement a program approval process, we found that none of the five departments we visited had written procedures to guide staff in analyzing and approving applications or application renewals. Additionally, we found that two departments we visited could not provide documentation of their reviews of the applications they had approved in the last five years. However, the applications approved in the last five years that we were able to review generally conformed to statutory requirements.

State law requires the departments to conduct annual on-site reviews of their programs, including monitoring sessions, to determine whether they are adhering to statutory requirements. To ensure that the programs are complying with statutory requirements, the departments would also need to perform on site reviews of program administration, such as the use of sliding fee schedules to assess the program fees batterers pay. However, based on our interviews with staff at all 58 departments and our review of selected programs at five departments, on-site reviews are not performed consistently. For example, the five departments we visited skipped years and programs in their on-site review efforts. Among the examples of programs straying from state requirements, we found one program that used an unqualified facilitator to oversee counseling sessions that were not single gender, as called for by law, and sessions that sometimes consisted only of movies that were not even related to domestic violence.

Further, while some departments have implemented program-monitoring practices beyond those required by law, such as meeting regularly with program directors; implementing performance measures, such as tracking program completion percentages and batterer recidivism, could improve program effectiveness. Another untapped measure of program effectiveness is the systematic collection of feedback from program participants.

We recommended that each department adopt clear, written policies and procedures for approving and renewing the approval of programs, including a description of how department personnel will document reviews of program applications.

We also recommended that each department consistently perform the on-site reviews required by state law. Specifically, a department should annually perform at least one administrative review and at least one program session review for each program. Further, the departments should document their reviews, inform programs of the results in writing, and follow up on areas that require correction.

Finally, we recommended that each department consider developing and using program performance measures, such as program completion and recidivism rates, and developing a mechanism to receive feedback from batterers on program effectiveness.

Butte County Probation Department's Action: Pending.

The Butte department indicated that it plans to implement the report's recommendations.

Los Angeles County Probation Department's Action: Pending.

The department in Los Angeles County indicated that it agrees with the recommendations and plans to implement them.

Riverside County Probation Department's Action: Pending.

The Riverside department indicated that it needs time to consult with the court and that it will provide a response at a later date.

San Joaquin County Probation Department's Action: Pending.

The department in San Joaquin County indicated that it plans, and in some cases has already started, to implement the recommendations.

San Mateo County Probation Department's Action: Pending.

The San Mateo department raised some concerns with the recommendations but did not specifically address whether it would be implementing them.

JUDICIAL COUNCIL OF CALIFORNIA

Its Governing Committee on Education Has Recently Proposed Minimum Education Requirements for Judicial Officers

REPORT NUMBER 2005-131, AUGUST 2006

Audit Highlights . . .

Our review of the Judicial Council of California's (Judicial Council) training programs for judicial officers revealed:

- Current education requirements apply only to new judicial officers and those hearing certain types of cases.***
 - The Judicial Council's governing committee on education recently proposed a Rule of Court that includes minimum education requirements for judicial officers; however, judicial officers have questioned the proposal.***
 - The Legislature does not appropriate funding specifically for judicial education; rather, the Judicial Council and the Administrative Office of the Courts allocate funds for this purpose.***
 - Expenditures we tested for the period July 2004 through December 2005 were for appropriate and allowable purposes.***
-

The Judicial Council of California's Administrative Office of the Courts' response as of November 2006

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to review and assess how funds appropriated to the Judicial Council of California (Judicial Council) are used for training judicial officers and to determine the processes and practices used in developing the budget for training judicial officers. We were asked to determine the amount appropriated and spent for training judicial officers over the last three years and to review the purposes and appropriateness of those costs. Finally, the audit committee asked us to review and assess management controls to ensure that funds appropriated for training are used for allowable activities and to select a sample of costs to determine whether they were valid. Specifically, we found:

Finding #1: The Judicial Council's governing committee on education recently proposed minimum education requirements for judicial officers.

The Judicial Council has authorized the governing committee that advises the Judicial Council on education with developing and maintaining education programs for the judicial branch. Additionally, the Judicial Council has authorized the Education Division of the Administrative Office of the Courts (AOC) with implementing the governing committee's comprehensive education program. The Education Division offers training to judicial officers in several legal areas; however, the majority of education programs are not required and judicial officers generally participate in most training at their own discretion. In fact, current requirements established by California Rules of Court and state law apply only to initial education for new judicial officers and initial and continuing education for those hearing certain types of cases. Further, although these judicial officers are required to attend certain courses, the AOC is generally not responsible for tracking or enforcing compliance with the education requirements. Rather, it is the responsibility of each judicial officer and court to ensure that the requirements are followed.

In fact, the Education Division generally cannot identify the individual judicial officers for which a specific training course applies because it does not track judicial officer assignments. At our request the Education Division compiled records demonstrating the number of newly appointed or elected judicial officers in the State for July 2002 through mid-April 2006, and we noted that although nearly all that we reviewed attended the required education programs, some did not do so within the required time.

Additionally, in February 2003 the governing committee began to review the concept of mandatory education and consider whether to submit a proposal to the Judicial Council on minimum education requirements for all judicial officers. As part of its process, the governing committee reviewed other state education models, assessed judicial officers' attendance at programs offered by the Education Division, considered prior efforts to establish minimum education requirements, and surveyed judicial officers in California.

Subsequent to that review process, the governing committee proposed a Rule of Court that included minimum education requirements for judicial officers. The proposed rule generally called for 30 hours of continuing education for all judicial officers in a three-year cycle, or 10 hours per year and required judicial officers to maintain records showing compliance with the requirements. Judicial officers questioned the governing committee's proposal, including the Judicial Council's constitutional authority to establish minimum education requirements. In October 2006 the Judicial Council adopted an alternate proposal that made some revisions to the governing committee's proposal in that the new Rules of Court provide that judges are expected to, and commissioners and referees must, complete 30 hours of continuing education in a three-year cycle.

We recommended that the Judicial Council implement a plan to ensure that there is a system for tracking participation to meet judicial education requirements and that the records kept are accurate and timely.

Judicial Council's Action: Partial corrective action taken.

The Judicial Council reported that the newly adopted Rules of Court require judicial officers to maintain records that show participation in judicial education. Additionally, the Judicial Council stated that these rules require each court to track commissioners' and referees' participation in education and completion of the minimum education requirements. Further, each presiding judge is required to retain judges' records of participation, which will be subject to periodic audit by the AOC. The presiding judge must report the data from these records on an aggregate basis to the Judicial Council, on a form provided by the Judicial Council, within six months after the end of each three-year period. The Judicial Council reported that the Education Division will be responsible for implementing this recommendation and developing the form that presiding judges will use to track judges' participation in judicial education.

Finding #2: The Education Division is in the midst of a lengthy process to change its approach to providing education programs.

The Education Division currently uses an event-based method of prioritizing and planning its education programs. According to the director of the Education Division, event-based planning is a method that focuses on filling a designated time slot with a training event that is recreated each time the event is planned. However, in 2000 the Education Division began a formal curriculum development process that will form the basis of a method for developing and planning its education

programs. The Education Division believes this curriculum-based approach, anticipated for completion within a few years, is more stable and can be designed to target specific audiences at entry, intermediate, or advanced career levels.

We recommended that the Education Division continue its efforts in designing curricula to use in developing its judicial education programs. Further, we recommended that, after implementing the curriculum-based planning approach, the Education Division should formally assess whether it has been successful.

Judicial Council's Action: Partial corrective action taken.

The Education Division reported that it is continuing its efforts in designing curricula to use in developing its judicial education programs and is implementing an evaluation process that includes an initial review of each new program developed. Further, the Education Division stated that, beginning in 2007, it plans to conduct an annual review of all program offerings to ensure the goals of the curriculum-based approach are met.

SAN FRANCISCO-OAKLAND BAY BRIDGE WORKER SAFETY

Better State Oversight Is Needed to Ensure That Injuries Are Reported Properly and That Safety Issues Are Addressed

Audit Highlights . . .

Our review of safety oversight on the Skyway project of the San Francisco-Oakland Bay Bridge East Span replacement revealed the following:

- The Division of Occupational Safety and Health (division) of the Department of Industrial Relations did not discover the potential underreporting of alleged workplace injuries and an alleged illness on the Skyway because it lacks procedures to ensure the reasonable accuracy of employer's annual injury reports.*
 - The division failed to adequately follow up on three of the six complaints received from Skyway workers, including an April 2004 complaint in which it found two alleged serious violations but did not issue citations to the contractor.*
 - The California Department of Transportation's safety oversight of the Skyway appears sufficient but improvements, such as increasing safety training and meeting attendance, could be made.*
-

REPORT NUMBER 2005-119, FEBRUARY 2006

Department of Industrial Relations' and the California Department of Transportation's responses as of August 2006

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to evaluate the Department of Industrial Relations' (department) Division of Occupational Safety and Health's (division) enforcement of worker safety and health laws and the California Department of Transportation's (Caltrans) oversight practices on construction of the East Span of the San Francisco-Oakland Bay Bridge (East Span).

In addition, the audit committee asked us to compare the number of injuries reported by workers on the East Span with the number reported on other large construction projects. The audit committee also asked us to evaluate the workplace safety policies, including any safety bonus programs of companies contracted to work on the East Span, and determine whether any disciplinary action has been taken against workers complaining of injuries or health issues. We focused our review on the safety of workers involved in construction of the Skyway project because it is the largest, most expensive component of the East Span currently being constructed and was at the center of certain media allegations. The Skyway is a section of the new East Span stretching most of the distance from Oakland to Yerba Buena Island.

Finding #1: The division does not exercise sufficient control over the injury reporting process to ensure that employers properly report injuries.

Although the reported injury rate of the prime contractor for the Skyway project is one-fourth that of the injury rate of similar projects, we question whether relying upon these statistics as an indication of project safety conditions is justified. The federal Occupational Safety and Health Administration's (federal OSHA) Form 300: Log of Work-Related Injuries and Illnesses (annual injury report), which employers are required to complete, summarizes the workplace injuries as defined in regulations, occurring during the year and is the basis for the calculation of injury rates. The acting chief of the division explained that division investigators review annual injury reports and

may ask employees about injuries as part of on-site inspections, but the division does not collect these reports and it does not have a systematic process to detect injuries that go unrecorded. In addition, the acting chief stated that because the resources of the division are finite, a decision to invest resources into the policing of the recording of injuries in the annual injury reports necessarily means that other resource-dependent activities will suffer. Consequently, the division was not aware of a number of alleged workplace injuries and an alleged illness that potentially meet recording requirements but were not included in annual injury reports of the Skyway's prime contractor.

To identify the underreporting of workplace injuries and to help ensure the reasonable accuracy of annual injury reports, we recommended that the division develop a mechanism to obtain employers' annual injury reports and design procedures to detect the underreporting of workplace injuries. If the division believes it does not have the resources necessary to undertake this task in light of its other priorities, it should seek additional funding from the Legislature for this effort. In designing these procedures, the division should take into account conditions that may attribute to the underreporting of injuries.

Division's Action: None.

The division has concluded that developing a mechanism to obtain and review employers' annual injury reports to detect the underreporting of workplace injuries would be impossible without having an electronic information management system. Further, it believes that the site investigation needed to establish a violation based on such a review would be time consuming. Using its recent investigation of the Skyway's prime contractor, Kiewit/FCI/Manson, a joint venture (KFM), as an example, the division indicates the investigation required over 400 hours of an inspector's time as well as managerial and legal review to prove that violations occurred. Even if it does cite an employer for violations, the division believes that the citations would likely be appealed, which will consume additional, substantial resources. The division also states that stakeholders at an April 2006 meeting of the Cal/OSHA Advisory Committee (advisory committee) concluded that reviewing employers' annual injury reports for the underreporting of workplace injuries would not be in the best interest of the division. Thus, rather than developing a proactive approach to detect the underreporting of injuries that we recommended, the division indicates it will continue to focus its resources on hazard abatement and direct intervention to prevent injuries and illnesses to workers. However, despite its concerns and inaction on our recommendation, the division indicates it is working with the two other department divisions on the feasibility of electronically receiving employer's reports of injury and possibly physician's reports of injury, which would facilitate an automated review of these reports for targeting employers for review.

Finding #2: The division did not follow up adequately on all Skyway complaints.

The division did not adequately follow up on three of the six complaints received from Skyway workers. In one instance, it chose to review an April 2004 complaint from former KFM employees, using the compliance assistance approach outlined by its informal partnership agreement with KFM. Because the agreement precluded issuing citations if KFM promptly abated hazardous conditions, the division did not issue citations that otherwise are required when it found two alleged serious violations of health and safety regulations while investigating this complaint. In another instance, because of internal miscommunication, the division failed to investigate a complaint at all. Finally, despite state law requiring it to conduct on-site investigations for employee complaints having a reasonable basis, the division decided to use its nonemployee complaint procedure to handle a complaint it received from a KFM employee.

We recommended that if the division believes it will use the partnership model in the future, it should create a plan for how it will operate under the model so its activities will provide appropriate oversight and be aligned with state law. Specifically, it should ensure that roles and responsibilities are communicated clearly and that critical information is shared with all relevant individuals.

Division's Action: Partial corrective action taken.

The division also discussed the continued use of the partnership model with the advisory committee. This discussion concluded that the division would attempt to keep as clear a separation as feasible between enforcement staff and compliance assistance staff when using the partnership model. Using its recent involvement with flavoring manufacturers located in California, the division indicates offering the manufacturers a consultative inspection in lieu of an enforcement inspection, with separate units performing these functions. The division's discussion with the advisory committee did not conclude that there was a need for a plan for how it will operate under the partnership model. In addition, the division states it will keep the advisory committee informed on emerging partnerships and seek its input on significant issues.

Finding #3: Caltrans' safety oversight on the Skyway project appears sufficient, but improvements could be made.

Although Caltrans worked to implement the safety oversight procedures required by its policies on the Skyway project, some improvements can be made to better emphasize safety. For example, the project safety coordinator's position within the organization has limited independence from construction managers. In addition, because Caltrans' inspectors observe the safety conditions of the work site while monitoring the construction and engineering aspects of KFM's work, it is important that they are able to identify unsafe conditions. To do so, Caltrans' policy and state regulations require that construction personnel attend safety meetings every 10 working days and attend general and job-specific hazard training. However, our review of the attendance records for a sample of Caltrans' staff assigned to the Skyway project, including all seven construction managers who set an example for staff, indicated they have attended only 76 percent of safety classes identified as necessary for their jobs and only 66 percent of mandatory biweekly safety sessions.

To ensure that the project safety coordinator assigned to the Skyway project has the necessary independence and authority to evaluate and report on project safety, we recommended that Caltrans make this position be independent of the managers whose safety performance the coordinator must oversee. In addition, we recommended that Caltrans should ensure its construction managers and staff on the Skyway project attend the mandatory biweekly safety sessions and other necessary safety training.

Caltrans' Action: Corrective action taken.

Caltrans indicates establishing a safety coordinator position that is responsible for overseeing employee and contractor safety on the East Span's construction projects. To provide for the position's independence, the position will submit safety reports to the East Span's construction manager, but a safety manager from Caltrans' District 4 office will supervise the position. An individual was hired for the position in October 2006. Caltrans also reports taking steps to improve attendance at required safety meetings and training, and indicates that employees' attendance has improved.

CALIFORNIA DEPARTMENT OF CORRECTIONS AND REHABILITATION

Investigations of Improper Activities by State Employees, January 2005 Through June 2005

INVESTIGATIONS I2004-0649; I2004-0681; I2004-0789
(REPORT I2005-2), SEPTEMBER 2005

California Department of Corrections and Rehabilitation's response
as of September 2006

Investigative Highlight . . .

Department of Corrections and Rehabilitation failed to account for 10,980 hours of union leave time at a cost to the State of \$395,256.

We investigated and substantiated allegations that the California Department of Corrections and Rehabilitation (Corrections) did not track the total number of hours available in a rank-and-file release time bank (time bank) composed of leave hours that union members donated.

Finding: Corrections failed to adequately account for time-bank hours.

Corrections lacked an adequate system of internal accounting and administrative controls over the number of hours in the time bank used by Peace Officer Association members which allowed Peace Officer Association members to take release time without Corrections knowing whether the time-bank balance was sufficient to cover the anticipated leave.

We identified three employee representatives whom Corrections released for a combined total of 10,980 hours between May 2003 and April 2005, which cost the State \$395,256, to perform duties for the Peace Officers Association and who were supposed to have this time charged against the time bank.

Corrections indicated that starting in the latter part of 2004, it began generating management reports that included information on time-bank use and donations and that it analyzes this information to better assess the overall impact of such union-leave activities. Although we acknowledge that Corrections has improved its monitoring of the time bank's activity, it still failed to account for a significant amount of time-bank hours used. Further, in the management reports that it used to assess current time-bank activity, Corrections did not accurately account for the hours that the three representatives used. Such errors

underscore the need for Corrections to improve its accounting to ensure that requests for time-bank use are charged against its balance and are sufficiently funded by employee leave donations.

Corrections' Action: Partial corrective action taken.

Corrections stated that it could not independently substantiate the 10,980 hours we reported as hours that Representatives A, B, and C did not charge to the union time bank between May 2003 and April 2005. Corrections believes that the State Controller's Office and Corrections' time accounting system cannot provide an accurate way to distinguish the type of union leave used. However, we substantiated the allegation when we reported the issue and Corrections has not requested to review our work papers. Further, it is not relevant to be able to distinguish the type of union leave used since our review of all available union leave categories at the State Controller's Office showed that none of the 10,980 hours were charged to any union leave categories.

Corrections reported that it has modified and implemented several changes to its tracking system that will allow it to track, report, and seek payment for union leave time. However, records from the State Controller's Office indicate that Corrections is still not charging the union time bank for the hours Representatives A and B are spending working on union activities. As a result, we have little confidence in Corrections' recent changes to its union leave tracking system. In addition to the 10,980 hours we previously reported, Corrections has failed to charge an additional 4,568 hours against the union time bank for hours Representatives A, B, and C spent working on union activities from May 2005 through June 2006. Overall, from May 2003 through June 2006, Corrections has failed to account for 15,548 hours of union leave at a cost to the State of \$589,661.

CALIFORNIA DEPARTMENT OF CORRECTIONS

Investigations of Improper Activities by State Employees, July 2004 Through December 2004

INVESTIGATION I2003-0834 (REPORT I2005-1),
MARCH 2005

California Department of Corrections' response as of
October 2006

Investigative Highlights . . .

The California Department of Corrections (Corrections) improperly granted registered nurses (nurses) an increase in pay associated with inmate supervision as follows:

- Between July 1, 2001, and June 30, 2003, Corrections paid 25 nurses \$238,184 more than they were entitled to receive.*
- Corrections failed to maintain sufficient documentation for 17 of the 25 nurses and although Corrections provided records for the remaining eight nurses, we found that most of these nurses failed to incur the required number of supervisory hours to merit the pay increase.*

We investigated and substantiated an allegation that the California Department of Corrections (Corrections)¹ improperly granted registered nurses (nurses) an increase in pay associated with inmate supervision that they were not entitled to receive.

Finding: Corrections improperly granted nurses premium pay associated with inmate supervision.

We found that 25 nurses at four institutions received increased pay associated with inmate supervision even though they either did not supervise inmates for the minimum number of hours required or they lacked sufficient documentation to support their eligibility to receive the increased pay. Between July 1, 2001, and June 30, 2003, Corrections paid these nurses \$238,184 more than they were entitled to receive.

Corrections reported that it could not provide documentation to support the pay increase it authorized for 17 of the 25 nurses because the institutions that employed these nurses either had no inmate supervisory hours to report, did not require nurses to track these hours, lacked sufficient documentation to support the hours claimed, or had destroyed all timekeeping records relating to inmate supervision. Although Corrections provided figures showing that the remaining eight nurses did supervise inmates, we found that in most instances these nurses failed to incur the required number of supervisory hours to merit the pay increase. For example, one nurse received a pay increase of approximately \$7,983 over a 16-month period. However, the nurse met the inmate supervisory threshold of 173 hours per month on only two occasions, resulting in an overpayment of \$7,030. Of the 25 nurses we reviewed that received this premium pay, we found that \$238,184 of the \$255,509 in inmate supervisory pay received was not justified.

¹ As of July 1, 2005, the California Department of Corrections has been renamed the Department of Corrections and Rehabilitation.

Corrections' Action: Partial corrective action taken.



Corrections reported that it has completed its analysis and determined that 14 of the 25 nurses identified in our report were not entitled to the pay increase and has collected or initiated collection for overpayments from these nurses. Corrections also reported that 11 of the nurses we identified were entitled to receive the pay increase. However, it was unable to provide documentation to support the premium pay for 10 of these nurses, stating that the institution only required the nurses to maintain copies of inmate supervision records for one year. Finally, Corrections reported that none of the nurses identified in our report are currently receiving the pay increase.

DEPARTMENT OF FORESTRY AND FIRE PROTECTION

Investigations of Improper Activities by State Employees, January 2006 Through June 2006

INVESTIGATION I2006-0663 (REPORT I2006-2),
SEPTEMBER 2006

Department of Forestry and Fire Protection's response as of
September 2006

Investigative Highlights . . .

***An employee with the
Department of Forestry and
Fire Protection:***

- Submitted false claims to receive \$17,904 in wages for 672 hours he did not work.***
 - Submitted a majority of his false claims to a supervisor with little or no knowledge of his actual attendance.***
-

We investigated and substantiated an allegation that Employee A, an employee of the Department of Forestry and Fire Protection (Forestry) submitted false time sheets and took time off without charging his leave balances.

Finding #1: Employee A fraudulently claimed hours he did not work.

Between January 2004 and December 2005, Employee A improperly claimed and received \$17,904 in wages for 672 hours he did not work. He submitted nine false claims over this two-year period. Because these false claims were submitted on numerous occasions over a significant period of time and under a variety of different circumstances, we believe it is reasonable to infer that this individual acted intentionally when submitting these false claims. Employee A's supervisor told us that having accurate staffing information is critical, and that he reviews daily staffing reports each morning to ensure that he has sufficient staff to respond to emergencies. We found numerous instances in which Employee A's time sheets conflicted with these reports.

For example, Employee A received \$9,884 by claiming he worked 372 hours when he was not present at work. During these hours, Employee B reported working to provide vacation coverage for Employee A. When questioned, Employee B stated that he worked all the hours he indicated for the purpose of covering for Employee A's vacation and that Employee A was not present during those hours. Furthermore, staffing reports confirm that Employee B was present for work and that Employee A was not.

Conversely, we identified 108 hours for which Employee A claimed he was providing vacation coverage for Employee B, even though Employee B's time sheet indicates he did not take leave and was at

work during all these hours. Staffing reports confirm that Employee B was present for work and that Employee A was not present. When asked about these hours, Employee B asserted he did not charge his vacation balances because he was at work. He added that he did not know why Employee A claimed to work these hours because Employee A was not present during any of the hours claimed. Employee A received \$2,906 for claiming these hours.

Finally, Employee A claimed to work 192 hours for which he received \$5,114, but staffing reports indicate Employee A was not present during this time. Neither Employee A's nor Employee B's time sheet indicates that Employee A was providing vacation coverage during these hours. Employee A claimed that he worked his regular work schedule on his time sheet, but staffing reports indicate that he was not at work during any of these hours.

Forestry's Action: Pending



Forestry has requested to review our work papers to pursue corrective action. No action as of December 27, 2006.

Finding #2: The employee took advantage of poor supervision and weak controls to receive payments for hours not worked.

By claiming wages for hours he did not work, Employee A took advantage of his supervisor's lack of effective oversight and communication among the various staff with the authority to sign time sheets. Simply comparing Employee A's time sheets and daily staffing reports with those of Employee B would have shown that Employee A was submitting inaccurate time sheets. Although we acknowledge that efficient and effective firefighting is one of Forestry's critical responsibilities, responding to emergency situations does not relieve Forestry of its responsibility to maintain adequate payroll controls or to keep complete and accurate attendance records, as required by state law.

The supervisor acknowledged that he had not been as diligent in verifying the authorization and hours worked for his employees as he should have been and when one employee claimed he was providing vacation coverage for the other, he did not always compare time sheets for both employees when approving them for payment.

The supervisor also pointed out that other supervisors may approve these time sheets. Because employees and supervisors may work in the field or at headquarters at any given time, Forestry's practice is to allow individuals other than an employee's direct supervisor to sign time sheets. Up to nine people have the authority to approve Employee A's and Employee B's time sheets. As a result, it is possible that the direct supervisor may sign one, both, or neither Employee A's or Employee B's time sheets for that month. Four individuals other than his direct supervisor signed a total of eight of Employee A's time sheets for the two-year period we reviewed. We believe Employee A was able to claim wages for hours not worked without being detected because he took advantage of a lack of oversight and communication among those with the authority to sign his time sheets. Additionally, it appears Employee A may have exploited this relaxed management practice by frequently having supervisors other than his direct supervisor sign his time sheets when he claimed hours he did not work.

For example, a battalion chief who rarely works in the field approved 240 of the 672 hours Employee A improperly claimed. With multiple approving authorities available, Employee A had the opportunity to have his time sheets approved by someone who, at best, would have limited firsthand knowledge of the hours he claimed. Most of the false claims Employee A submitted were signed by someone other than his direct supervisor.

Forestry's Action: Partial corrective action taken.

Forestry issued a memo on December 1, 2006, to all stations in the unit in which the employee worked, outlining several steps intended to address the findings in the investigative report.

Supervisors with direct supervisory responsibility over a given employee are the only supervisors authorized to sign time reports for that employee. Program managers will compare each employee's work time with the appropriate daily staffing report. Employee's requesting time off that is not part of their annual vacation request process will be required to forward their request to a Division Chief or Duty Chief for approval per the "Master Schedule" for the unit. The memo includes a reminder to Battalion Chiefs to ensure that station log books, which are legal documents used to record and verify personnel transactions at the station level, are complete, accurate, and secure.

Management will also have the ability to access the department's personnel database to review staffing and personnel transactions, as well as recorded phone lines and radio transmissions to review conversations related to staffing and personnel decisions.

Finally, the memo reminds recipients that Battalion Chiefs will have the primary oversight responsibility for all personnel in their Battalions, and that Division Chiefs will conduct audits to ensure that all policies and procedures are followed and report their findings to the Unit Chief.

DEPARTMENT OF PARKS AND RECREATION

Lifeguard Staffing Appears Adequate to Protect the Public, but Districts Report Equipment and Facility Needs

REPORT NUMBER 2004-124, AUGUST 2005

Audit Highlights . . .

Our review of the sufficiency of the Department of Parks and Recreation's (Parks) staffing levels and other resources at state beaches necessary to protect the public found that:

- Even though Parks reported a significant increase in estimated beach attendance and lifeguard workload from 2000 to 2004, it did not report an increase in drownings where there was a staffed lifeguard tower or station.*
- We noted instances in which Parks' aquatic safety statistics were incomplete or inaccurate.*
- Although we estimate that Parks' lifeguards worked slightly fewer hours in 2004 than in 2000, its lifeguard staffing patterns and its mix of permanent and seasonal lifeguards seem reasonable.*

continued on next page . . .

Department of Parks and Recreation's response as of October 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review the sufficiency of the Department of Parks and Recreation's (Parks) staffing levels and other resources necessary to protect the public at state swimming beaches. Specifically, the audit committee asked the bureau to review and evaluate the method Parks uses to determine what constitutes a sufficient number of lifeguards at state swimming beaches. As part of an assessment of whether Parks has a sufficient number of lifeguards at state swimming beaches, the audit committee asked us to determine how Parks' lifeguard staffing levels compare with those of cities, counties, and other states, if possible. The audit committee also asked us to evaluate whether Parks has sufficient equipment for lifeguards at state swimming beaches and whether Parks adequately budgeted for lifeguards and equipment to protect the public at those beaches. Finally, the audit committee requested that we determine the number of drowning incidents reported at state, county, and city beaches and whether there is a correlation between the number of drownings and either the number of lifeguards or the resources available to lifeguards stationed at state swimming beaches. Our review revealed the following:

Finding #1: Lifeguard staffing levels have been sufficient to prevent an increase in drownings at guarded waters despite a reported increase in beach attendance and lifeguard workload.

Despite a reported increase in beach attendance and lifeguard workload, Parks reported a total of seven drownings in guarded waters at state beaches within its lifeguard districts over the five-year period from 2000 through 2004. Parks defines guarded water as a location within the viewing area of a staffed lifeguard tower or station. The three local governments we surveyed reported similar results. This suggests that the presence of lifeguards has been effective at state and local beaches in minimizing drownings in guarded waters. These trends are similar to a national trend discussed in a 2001 report by the Centers for Disease Control and Prevention (CDC), which concluded that the

- ☑ *While Parks has reported an increasing number of drownings in unguarded waters over the last five years, adding more lifeguards may not be an appropriate response.*
 - ☑ *Parks' districts with aquatic safety programs have significantly decreased their spending on the equipment and facility operations portion of their support costs from fiscal years 1999–2000 to 2003–04.*
 - ☑ *Even though lifeguard sectors report a need for additional resources to maintain and add to their lifeguard equipment and facilities, Parks' management believes that the department has allocated sufficient funds to provide adequate aquatic safety.*
-

total number of reported drownings at lifeguard-staffed beaches has remained relatively stable since 1960 although both beach attendance and rescues by lifeguards have risen steadily.

Based on the data Parks reported, attendance at state beaches and lifeguard workload increased significantly from 2000 to 2004. Specifically, Parks' lifeguard districts reported that attendance at state beaches increased from 23.4 million in 2000 to 41.4 million in 2004, an increase of nearly 77 percent. Parks and the three local beaches we surveyed use various methods involving some level of estimation to calculate their reported attendance. Therefore, it is difficult to closely compare the attendance data they reported. Consistent with its reported increase in beach attendance, Parks reported that the overall workload of lifeguards at state beaches increased significantly from 2000 to 2004. The most dramatic increase was in the number of warnings issued and preventive actions taken. Parks indicated that it issued almost four times the number of warnings and took almost twice the number of preventive actions in 2004 as it did in 2000. In comparison to its other workload statistics, Parks reported more modest increases in aquatic rescues and medical aids of 27 percent and 18 percent, respectively, from 2000 to 2004.

Finding #2: In certain instances, Parks' aquatic safety statistics were incomplete or inaccurate.

Our review of Parks' aquatic safety data for the five-year period ending in 2004, identified instances in which the data were incomplete or inaccurate. For example, we found that one lifeguard district failed to report most of its aquatic safety statistics for 2001. In addition, we found three other lifeguard districts that did not report swimmer-related rescues for 2001 and another that reported certain duplicate statistics for 2001 and 2002. In addition, Parks originally reported to us that 36 unguarded-water drownings occurred within state park boundaries in 2004. Unguarded water is an area where Parks either has no lifeguard assigned at all or has a lifeguard assigned but the waters are outside the immediate view of the lifeguard. After we reviewed a summary of these incidents and a sample of the related public safety reports it provided, Parks revised the number to 31.

These kinds of problems raise questions about the reliability of the aquatic safety data that Parks reported. Although we did not find an instance where the inaccurate data caused Parks to make an inappropriate management decision, if it is going to spend the time and effort to collect statistics regarding aquatic safety, it is reasonable to expect the information to be as accurate as possible. In addition, ensuring the completeness and accuracy of its aquatic safety statistics will help Parks make better management decisions regarding the allocation of its aquatic safety resources.

We recommended that Parks should:

- Make certain its districts that are required to track and report aquatic safety statistics are submitting them as required.
- Require its staff to review the statistics for accuracy and completeness.

Parks' Action: Corrective action taken.

According to Parks, its current policy for reporting on aquatic safety statistics is identified in the department's operation manual (manual). The manual outlines the process for collecting data from field staff and makes each supervisor responsible for ensuring the information is reported in a monthly activity report and reported through each district's chain-of-command. In addition, to help the accuracy of data tabulation, Parks updated its daily log and monthly activity reports into a spreadsheet that automatically tabulates into a year-end summary. Also, to emphasize the need for accuracy, completeness, and adherence to reporting requirements, a memo requesting aquatic statistics reporting is sent out each November to all district superintendents with aquatic safety programs. Parks reported that the outcome of the 2005 aquatic safety statistics reports showed improvement. Finally, in addition to follow-up on errors by the aquatic specialist, the department reinforced requirements through training in March 2006.

Finding #3: Although we estimate that Parks' lifeguards worked slightly fewer hours in 2004 than in 2000, its lifeguard staffing patterns and its mix of permanent and seasonal lifeguards seem reasonable.

Parks' lifeguards worked slightly fewer hours in 2004 than they did in 2000. Based on payroll data we obtained from the State Controller's Office, we estimate that in 2000, lifeguards worked about 376,000 hours compared with 357,000 in 2004.

Parks appears to adjust its lifeguard staffing levels to deal with changes in beach attendance and to use a reasonable mix of permanent and seasonal lifeguards to provide public protection at state beaches. Parks indicated that it attempts to increase the staffing levels of lifeguards in the summer months to cope with increased attendance at state beaches. According to Parks, the peak attendance season generally runs between April and October each year. For example, we found that the total number of hours lifeguards worked in the San Diego North sector during 2004 generally fluctuated with changes in reported attendance. In addition, this sector appeared to keep pace with increasing attendance, because the four months with the most hours worked by lifeguards (June through September) coincided with the four months in which the reported levels of attendance were highest.

In addition, we found that, based on the average number of hours lifeguards worked each month over the last five years, Parks used seasonal staff to augment the number of lifeguards on duty during the peak season. Permanent lifeguards worked a relatively steady number of hours each month on average over the five-year period, whereas seasonal lifeguards worked a great deal during the summer months but very little during the nonpeak season. This staffing pattern indicates that Parks relies on permanent lifeguards to protect the public in nonpeak months, while this task falls primarily to seasonal lifeguards during the peak attendance season.

Although seasonal lifeguards contribute heavily during the peak attendance season, 94 percent of seasonal lifeguards worked fewer than 1,000 hours in 2004, with 70 percent working fewer than 500 hours. Given that Parks set 1,778.5 as its standard measure of the annual hours a full-time employee works, it apparently does not need to convert any of its seasonal lifeguards to permanent status.

Finally, Parks requires all its permanent lifeguards to be peace officers. Parks reported that the workload levels related to the law enforcement aspects of a lifeguard's job have increased dramatically. Since Parks relies primarily on permanent lifeguards for about five months of the year during the nonpeak attendance season, it seems important for Parks' permanent lifeguards to be peace officers.

Finding #4: While Parks has reported an increasing number of drownings in unguarded waters, adding more lifeguards may not be an appropriate response.

Parks' lifeguard districts have reported an increasing number of drownings in unguarded waters over the last five years. The majority of the 31 unguarded-water drownings in 2004 occurred in north coast and inland lifeguard districts that generally receive less beach attendance than the south coast lifeguard districts. Overall, given the low number of drownings in guarded waters discussed earlier and the increasing number occurring in unguarded waters, one might conclude that adding more lifeguards would decrease the number of drownings in unguarded waters. However, although every drowning is a tragedy, based on the circumstances surrounding the 31 reported drownings in unguarded waters during 2004, we believe that adding more lifeguards may not be an appropriate response. In particular, for more than half these incidents, the level of lifeguard staffing did not appear to be an issue. Further, at the locations of the remaining incidents, it is not clear that Parks would choose to add more lifeguards if it received additional resources.

We recommended that Parks monitor the circumstances surrounding drowning incidents that occur in unguarded waters to help it determine the amount and best allocation of resources sufficient to protect the public.

Parks' Action: Corrective action taken.

According to Parks, the aquatic specialist follows up on all reported drowning incidents and analyzes the surrounding circumstances to consider possible actions to take regarding the amount and best allocation of aquatic safety resources. Based on this type of review, the aquatic specialist indicated that there were 24 drowning deaths in California state parks during calendar year 2005, a decrease of about 22 percent from 2004. Parks attributed the decrease to lower attendance driven by such factors as numerous foggy days during months that are normally busy because of warm weather and record numbers of jellyfish stings during July and August. After reviewing the circumstances surrounding the 2005 drowning incidents, Parks concluded that reallocating current lifeguard and aquatic safety resources within the department would not be a reasonable approach to decrease the number of drowning incidents. Nevertheless, Parks indicated that it received a budget augmentation for aquatic safety programs and it is identifying where increasing seasonal staff will have the greatest benefit for public safety. It is also pursuing the purchase of additional personal watercraft to support lifeguard programs and is developing a comprehensive brochure on aquatic safety to assist in educating the public.

Finding #5: Continued deferral of equipment repair and maintenance may eventually have a negative impact on Parks' ability to adequately protect the public.

Lifeguard districts significantly decreased their spending for equipment and facility operations costs from fiscal years 1999–2000 to 2003–04. As a result, according to the sectors within the lifeguard districts that operate aquatic safety programs (lifeguard sectors), some of their lifeguard equipment and facilities are in poor condition and in need of repair or replacement. Staff at Parks indicated that it generally cuts back on equipment and maintenance expenses when faced with budget cuts for operating expenses because they are nonfixed or discretionary expenses. This is consistent with responses to our survey, in which many lifeguard sectors expressed a need for additional resources to maintain and add to their lifeguard equipment and facilities. These sectors indicated needing primarily vehicles, rescue boats, and portable towers. In addition, although Parks plans to replace two of its permanent lifeguard facilities and expand another, lifeguard sectors reported that several other facilities are in need of repair or replacement. However, management at Parks believes that it has allocated sufficient funds to provide adequate aquatic safety while balancing the needs of all its programs. In contrast, the three local governments we surveyed reported having sufficient and operable equipment.

Although no instances came to our attention in which the poor condition of equipment affected the lifeguard sectors' ability to provide aquatic safety, we observed a few examples of equipment in poor condition. However, we were unable to assess whether the additional equipment needs reported by the lifeguard sectors were necessary, because we are not aware of any standard that specifies the amount of equipment lifeguards must have to perform their duties. Finally, although most lifeguard districts said they need additional funds to maintain their equipment, we are uncertain they would spend the additional funds to fulfill those needs. According to Parks' budget office, the lifeguard districts have some control over their spending for nonfixed or discretionary costs, such as equipment and facilities maintenance, overtime, and temporary staffing.

We recommended that Parks monitor how long it can continue to curtail spending on lifeguard districts' equipment and facilities to avoid a potentially negative impact on its ability to protect the public. In addition, if Parks decides to allocate additional funding to its aquatic safety programs in the future, either for equipment expenses or for additional lifeguards, it should work closely with its lifeguard districts to clarify the intended purposes of any proposed changes in spending. For example, if Parks decides to allocate additional funding to augment its lifeguard staff, it should carefully consider whether to expand coverage into unguarded waters in districts with existing aquatic safety programs or to implement new aquatic safety programs in districts at coastal or inland waterways without lifeguard coverage.

Parks' Action: Pending.

According to Parks, its 2006–07 budget contains an augmentation for lifeguard aquatic safety programs. As a result, it is identifying the programs with the highest needs to determine its priorities and where the augmentation will have the greatest benefit for public safety. Parks also expects to receive \$250 million for the repair of critical infrastructure in state parks in 2006–07 and plans to address the need for replacement and repair to districts' lifeguard facilities through this allocation. Finally, Parks stated that given the department's need to balance limited resources across all core programs, it is apparent that even critical need programs and facilities cannot always be fully funded in the manner it would prefer.

Finding #6: Lifeguard sectors lack evidence to support their reported need for automatic external defibrillators.

Although 15 of the 19 lifeguard sectors we surveyed said they need additional automatic external defibrillators (AEDs), Parks does not presently capture data that would be sufficient to assess its need for these devices. An AED is a piece of medical equipment that lifeguards can use to rescue victims of sudden cardiac arrest. For instance, lifeguard sectors reported that they used AEDs in six cases in 2004, which is the year they began reporting the number of times AED units were used. However, these reported cases might understate Parks' need for AEDs because they may not indicate the number of instances in which AEDs should have been used. A more relevant statistic would be to track the number of times in which a rescue required the use of an AED, but one was not available. Parks could then use these data to assess whether it needs additional AEDs and, if so, how many.

We recommended that, to clarify to what extent it needs AEDs, Parks should track not only its actual usage of AEDs but also the number of times it needed them but they were unavailable. Similar procedures could apply to demonstrating the need for other equipment.

Parks' Action: Corrective action taken.

In the November 2005 memorandum to district superintendents, the chief of Parks' public safety division instructed staff to record the number of medical cases in which AEDs were needed, but were unavailable, by using one of the boxes marked "OTHER" at the bottom of the form used to gather statistics with the heading "AED needed/unavailable."

DEPARTMENT OF FISH AND GAME

The Preservation Fund Comprises a Greater Share of Department Spending Due to Reduction of Other Revenues

REPORT NUMBER 2004-122R, JUNE 2005

Audit Highlights . . .

Our review of the Department of Fish and Game's (Fish and Game) administration of its preservation fund disclosed the following:

- The preservation fund together with the General Fund pays for many of Fish and Game's programs.*
- Although revenues to the preservation fund have increased due to fee increases that took effect in fiscal year 2003-04 for sport fishing licenses, Fish and Game has had its General Fund appropriation reduced by over \$20 million between fiscal years 2001-02 and 2003-04.*
- Also, between fiscal years 2001-02 and 2003-04, Fish and Game spent down its preservation fund reserves significantly.*
- The amount Fish and Game spent on its hatcheries declined less than 3 percent from fiscal years 2001-02 to 2003-04 while spending of other programs declined more significantly.*

continued on next page . . .

Department of Fish and Game's response as of September 2006

At the request of the Joint Legislative Audit Committee we reviewed the Department of Fish and Game's (Fish and Game) handling of the preservation fund as well as the funding of the State's fish hatcheries from fiscal year 2001-02 through 2003-04. The audit examined Fish and Game's setting, collecting, and spending of and accounting for revenue generated by the sale of sport fishing licenses. Also, the audit examined Fish and Game's allocation of revenue to program activities, their allocation of indirect costs, and their assessment of the sufficiency of funding levels. Finally, we determined trends in the funding of the hatcheries.

Finding #1: Fish and Game has not established written spending priorities, nor has it identified sufficient funding levels for preservation fund programs.

Because it has not measured the sufficiency of funding levels, Fish and Game is at a disadvantage in accurately projecting the funding necessary to operate programs at their intended capacities. This affects the department's ability to justify program funding allocations as it is difficult to build a convincing case for a given level of funding without having first defined a target service level and the associated costs. Further, Fish and Game never adopted a formal set of priorities to guide its spending. While Fish and Game has had to address frequent budget reductions, it has done so without the benefit of a written list of funding priorities for its activities. Because of recent reductions of General Fund support, and because Fish and Game did not reduce its expenditures to the same degree that revenues declined, the department spent down the reserves that existed in the preservation fund. Fish and Game projects that at the end of fiscal year 2004-05, it will have a balance of only \$665,000 in the preservation fund. This is in comparison to the \$24.5 million fund balance at the beginning of fiscal year 2001-02.

We recommended that Fish and Game update its strategic plan and develop annual operational plans with specific goals and then determine the funding necessary to meet these goals allowing it to better measure the sufficiency of funding for its programs.

- ☑ *Although, a long-range spending plan could serve as a useful tool to guide department decisions, especially in times of fluctuating funding, the department lacks such a tool.*
 - ☑ *Finally, Fish and Game failed to follow its own procedures for properly allocating its indirect costs, resulting in overcharges to some programs and undercharges to others.*
-

Fish and Game's Action: Partial corrective action taken.

In September 2006, Fish and Game reported to us that it had completed the update of its strategic plan. According to Fish and Game, its strategic plan identifies the core fundamental priorities and its executive office has initiated a restructuring of the department in order to operate more effectively. In addition, Fish and Game stated that a complete review of its time reporting methodology and budget structure is underway. Activity codes are scheduled for realignment to better correlate to Fish and Game's funding priorities and mandates. Fish and Game stated it is also in the midst of developing a priority-based budget process for managing its funds and activities. When this process is complete, targeted for July 2007, Fish and Game stated it will be able to develop team action plans to execute more new strategies that will improve performance.

Finding #2: Fish and Game spent more for both dedicated and non-dedicated programs than it collected in revenue.

All revenue collected and deposited into the preservation fund can be spent only to support preservation fund programs. Within the fund, certain revenues are restricted to specific purposes established in statute; Fish and Game holds such dedicated money in separate accounts of the preservation fund. For example, Fish and Game Code, Section 7149.8, requires persons taking abalone to purchase an abalone report card in addition to a standard sport-fishing license. Section 7149.9 requires that abalone report card revenue be deposited into the abalone restoration and preservation subaccount within the preservation fund. This section further stipulates that the funds received by this subaccount are to be expended for abalone research, habitat, and enforcement activities. In fiscal year 2003–04, the preservation fund contained 26 of these dedicated accounts, representing 15 percent of the total expenditures from the fund.

Although dedicated programs have revenue streams to support them, from fiscal years 2001–02 through 2003–04, Fish and Game expended more on dedicated programs in total than these programs generated in revenue. For example, the streambed alteration agreement program carried forward a negative beginning balance ranging from \$1.4 million to more than \$4.4 million during these three fiscal years. The program annually expended close to \$3 million, although it only collected between \$1.3 million and \$1.6 million in annual revenues. Fish and Game told us that the streambed alteration agreement program and similar dedicated programs used existing account balances to make up for these over-expenditures.

In fiscal years 2001–02 and 2002–03, the non-dedicated portion of the preservation fund incurred even more expenditures in excess of revenues. Non-dedicated expenditures exceeded non-dedicated revenues by \$4.3 million in fiscal year 2001–02 and by \$11.6 million in fiscal year 2002–03.

We recommended that Fish and Game take measures to ensure that revenues streams are sufficient to fund each of its programs, which may require that fees be adjusted or that the department's General Fund be augmented to sustain dedicated and non-dedicated program operations.

Fish and Game's Action: Partial corrective action taken.

Fish and Game reported it addressed this issue through a complete review of its revenues and expenditures. Fish and Game stated that this action, adopted in the fiscal year 2006–07 Governor's Budget, includes a combination of appropriately aligning expenditures to revenues, program adjustments, fee increases, and a General Fund offset of the deficit in its preservation fund. According to Fish and Game, effective November 12, 2005, a fee increase was approved by the Office of Administrative Law for the lake and streambed alteration (dedicated) account and, along with an infusion from the General Fund, this fund is now aligned.

Finding #3: Fish and Game has not demonstrated that it uses allowable resources to cover certain deficit spending.

It is not clear that Fish and Game always uses dedicated resources in the preservation fund for their intended purposes. Two of the preservation fund's dedicated accounts, as well as the non-dedicated account, had negative overall balances as of June 30, 2004, and some of these deficits have persisted for several years. In essence, accounts with positive balances, whose revenues have exceeded expenditures over the lives of the accounts, are subsidizing the excess expenditures of the accounts with deficits. No problem would exist if the non-dedicated account was covering these deficits because its resources can be used for a broad range of preservation purposes, including any of the purposes for which the dedicated accounts were created. However, with the non-dedicated account itself running a deficit, the only resources available in the preservation fund to cover deficit spending are those dedicated accounts with positive balances. In addition to the non-dedicated account, the lake and streambed alteration account, and the bighorn sheep dedicated account had negative overall balances as of June 30, 2004. For the three accounts, the deficit was \$14.7 million in fiscal year 2003–04.

Fish and Game agrees that three of its dedicated accounts have negative overall balances. As a response to these negative funding issues, Fish and Game indicates it has reduced its planned spending by over \$1 million in an effort to bring the preservation fund "into balance." However, it did not specify the impact of the proposed reduction on the individual dedicated accounts. Furthermore, Fish and Game has submitted an increased fee proposal for the lake and streambed alteration account to improve the fund condition.

We are still concerned that Fish and Game's responses to these negative balance issues are insufficient. The revenues that flow into the dedicated accounts are restricted to the purpose for which the program and the account were established. Therefore, using the resources of one account to pay for the expenses of another account may not be appropriate. For example, the enabling legislation for the Bay-Delta sport fishing enhancement stamp dedicated account makes it clear that funds collected from the sale of this stamp are for the long-term benefit of Bay-Delta sport fisheries, not to pay for the expenses of another program. We believe it is not sufficient for the department to address these issues by simply going forward with reductions in spending where necessary and increases in fees, although this is a good first step.

We recommended that Fish and Game avoid borrowing from its dedicated accounts to fund expenditures of other accounts. If this is temporarily unavoidable, the department should track those accounts that were the source of the borrowed resources and ensure that the

law establishing the account that was borrowed from allows for such borrowing. We further recommended that Fish and Game identify those dedicated accounts that have been used to pay for expenditures of other accounts and pay back these lending accounts.

Fish and Game's Action: Partial corrective action taken.

Fish and Game reported it addressed this issue through a complete review of its revenues and expenditures. Fish and Game stated that this action, adopted in the fiscal year 2006–07 Governor's Budget, includes a combination of appropriately aligning expenditures to revenues, program adjustments, fee increases, and a General Fund offset of the deficit in its preservation fund. According to Fish and Game, effective November 12, 2005, a fee increase was approved by the Office of Administrative Law for the lake and streambed alteration (dedicated) account and, along with an infusion from the General Fund, this fund is now aligned.

Finding #4: Fish and Game advanced \$1.4 million from the preservation fund to the Native Species Conservation and Enhancement Account that may not be paid back.

As of June 30, 2004, Fish and Game's preservation fund showed a loan of \$1.4 million to the Native Species Conservation and Enhancement Account (native species account). The loan was formalized in 1989. Fish and Game recorded payments from the native species account to the preservation fund in fiscal years 2001–02, 2002–03, and 2003–04, but Fish and Game could not provide to us an amortization schedule that would demonstrate when the loan would be repaid.

The native species account's revenue sources are donations received for the support of nongame and native plant species conservation and enhancement programs, an appropriation in the annual budget act from the General Fund, and revenues from the sale of annual wildlife area passes and native species stamps, as well as promotional materials and study aids.

Fish and Game told us that it will continue to make annual payments on this loan, but only to the extent of revenues received into the native species account. Unfortunately, revenues to the native species account have not been sufficient to pay down the loan. Therefore, unless revenues to the native species account increase significantly, this loan may never be paid back. When the loan is not collected, the resources are not available for preservation fund programs.

We recommended that Fish and Game resolve the advance from the preservation fund to the native species conservation and enhancement account through administrative or legislative means.

Fish and Game's Action: Corrective action taken.

Fish and Game stated that it had been tracking all postings to the interfund loan, established by statute in 1988, between the preservation fund and the native species conservation and enhancement account. According to Fish and Game any payments, interest, adjustments, and revenue posted to the preservation fund have been closely monitored for the ongoing repayment of the loan.

Fish and Game stated that, as of June 30, 2005, the loan balance was \$1,150,950. However, the department also stated that revenues and income for the native species conservation and enhancement account have dwindled over the past four years, from approximately \$100,000

per year to \$19,000 per year. Because of the insufficient revenues in the account, Fish and Game requested that a General Fund repayment of the loan be made and, according to the fiscal year 2006–07 Governor’s Budget, the loan to the preservation fund has now been repaid with interest.

Finding #5: Fish and Game failed to allocate indirect costs in accordance with its cost allocation plan.

Several of Fish and Game’s activities have been created for the benefit of all the divisions of the department. These activities, which it calls “shared services,” are the license revenue branch, legal services, air services, and geographic information systems. Fish and Game did not adjust the percentages used in allocating the indirect costs associated with these shared services to the divisions that benefited. It used the same percentages for allocating these indirect costs for fiscal years 2001–02, 2002–03, and 2003–04. As a result, some programs were overcharged, while others were undercharged for these costs. Fish and Game has not updated the percentages it used since prior to fiscal year 2001–02, the first year examined by this audit.

According to Fish and Game’s own guidelines for allocating shared costs, percentages are to be adjusted annually based on either the governor’s budget for the prior year or the actual services provided. Because annual adjustments were not made to the allocation ratios from fiscal years 2001–02 through 2003–04, Fish and Game inaccurately charged these programs for indirect costs. Our comparison showed that from fiscal year 2001–02 through 2003–04, the department’s calculations overcharged the hatcheries and fish planting facilities a total of \$1.3 million of the license revenue branch’s and legal service’s indirect costs. During the same time period that some programs were overcharged, Fish and Game’s outdated percentages undercharged other programs for license revenue branch and legal service costs.

To prevent inequitable distributions of indirect costs and administrative expenses, we recommended that Fish and Game review and update the percentages used in its allocations method annually.

Fish and Game’s Action: Corrective action taken.

Fish and Game stated that it has completed its review and update of the indirect cost charge percentages used in the annual allocation methods to ensure correct charges are made against various fund sources.

CALIFORNIA DEPARTMENT OF CORRECTIONS AND REHABILITATION

Audit Highlights . . .

Our review of the California Department of Corrections and Rehabilitation's (department) intermediate sanction programs for parole violators revealed the following:

- Although the department had data regarding parole violators in the programs, it did not analyze the data or establish benchmarks that it could measure the programs' results against.*
- The department's savings were substantially less than anticipated because its savings estimates were based on unrealistic expectations and the programs were implemented late.*
- To minimize the risk to public safety, less dangerous parole violators were placed in the intermediate sanction programs; however, a small percentage of parole violators were convicted of new crimes during the time they otherwise would have been in prison.*
- Although implementation of the intermediate sanction programs was planned for January 1, 2004, the implementation was delayed due to labor negotiations, a department leadership change, and unanticipated contracting problems.*

The Intermediate Sanction Programs Lacked Performance Benchmarks and Were Plagued With Implementation Problems

REPORT NUMBER 2005-111, NOVEMBER 2005

California Department of Corrections and Rehabilitation's response as of November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review how the California Department of Corrections and Rehabilitation (department) handles parole violators under its New Parole Model policy. Specifically, the audit committee requested that we assess the steps used and the extent to which the department has implemented and monitored its new parole policy, focusing on the intermediate sanction programs, including electronic monitoring, substance abuse treatment control units, and community detention houses. In addition, the audit committee asked us to determine whether the department had established performance measures to measure the efficacy of its parole policy in lowering the recidivism rate.

On April 11, 2005, shortly after the audit committee approved the audit, the department secretary terminated the department's use of the intermediate sanction programs as an alternative to parole revocation and return to prison. The programs we were asked to audit had been operating for 14 months or less when they were canceled, so the data available for our analysis were limited.

Finding #1: The department could have established benchmarks and evaluated the intermediate sanction programs against them, but did not.

Although the department's Division of Adult Parole Operations (parole division) had gathered data about the intermediate sanction programs, it did not analyze the data to evaluate the programs' impact on public safety. In addition, the parole division did not establish benchmarks, such as acceptable return to custody rates for participants that it could measure the program against. Monitoring the programs' impact on public safety against established benchmarks would have provided

information relevant to the secretary's decision to terminate the programs, such as whether the percentages of parolees in the programs who were convicted of new crimes or who committed parole violations when they otherwise would have been in prison were within acceptable limits. In addition, had the parole division established benchmarks for what it considered success, such as a minimum number of parole violators completing the programs, and analyzed the available data—similar to what we did for our report—the secretary could have used the analyses in deciding whether terminating the intermediate sanction programs was the best choice. Finally, by defining benchmarks before implementing the programs, the parole division could have determined whether it needed additional data to measure against the established benchmarks.

We recommended when planning future intermediate sanction programs, that the parole division decide on appropriate benchmarks for monitoring performance, identify the data it will need to measure performance against those benchmarks, and ensure that reliable data collection mechanisms are in place before a program is implemented. After implementing a new intermediate sanction program, the parole division should analyze the data it has collected and, if relevant, use the data in its existing databases to monitor and evaluate the program's effectiveness on an ongoing basis.

Department's Action: Partial corrective action taken.

The parole division indicates it has established specific benchmarks for the outcomes that it expects to achieve for each of its seven parole programs and it is also beginning to review these benchmarks against the cost effectiveness of the programs. In the future, after it believes that participation levels in the programs are stable, the parole division states that it will develop additional benchmarks to measure the performance of the seven parole programs, such as program referrals, enrollments, occupancy rates, hours of capacity, and program placement. The parole division also states that it has designed a database to record this information and that program goals and actual numbers were posted on the parole division's internal Web site for management and staff to review. Finally, it states that the department's office of research completed a performance review of the parole programs in October 2006 to assess the reasonableness of the outcome goals.

Finding #2: Late implementation and unrealistic expectations prevented the intermediate sanction programs from achieving desired savings.

For various reasons, none of the intermediate sanction programs were implemented by January 1, 2004, as planned, so parole violators could not be placed in the programs as early as had been intended. Compounding the delayed implementation was the parole division's unrealistic expectation that the programs would be fully occupied by the first date of implementation. The parole division also did not take into account that there would be a ramping-up period during which occupancy in the programs would increase gradually, but instead, assumed full capacity from the beginning.

The parole division did not evaluate the data it had about the Halfway Back and Substance Abuse Treatment Control Units (SATCU) programs, so it was unable to calculate the savings achieved by the programs. It was apparent, however, that the savings were substantially less than anticipated because of the delays in implementing the programs and placing parole violators in them. Using the parole division's estimates and data about the programs and the participants, we estimated that for the 5,742 parole violators placed in the programs by December 31, 2004—2,567 in the

SATCU program and 3,175 in the Halfway Back program—the department saved \$14.5 million—\$7.4 million and \$7.1 million, respectively. The savings equates to an average \$1.2 million per month over a 12-month period, far short of the average \$8.4 million per month it would have had to save to achieve its planned savings of \$50.2 million for fiscal year 2003–04 and \$100.5 million for fiscal year 2004–05.

We recommended that the parole division ensure the savings estimates developed during program planning are based on reasonable assumptions, and if those assumptions change, update the savings estimates promptly.

Department's Action: Corrective action taken.

The parole division concurs with our recommendation and indicates it will ensure that any discussions with legislative staff or other researchers include reasonable projections or estimates, and that it updates and reassesses projected savings in a timely manner. Specifically, when developing its fiscal year 2006-07 budget, the parole division indicates adjusting the assumptions and savings estimates related to its parole programs based on current data.

Finding #3: The parole division could have established a performance baseline and used it to analyze the effect the intermediate sanction programs had on parolee behavior, but did not.

The parole division hoped that parole violators would benefit from services they received while in the SATCU and Halfway Back programs to help them integrate back into society and successfully complete their parole terms, resulting in a lower recidivism rate. Although the tradeoff may be difficult, achieving the desired benefits of using intermediate sanctions in lieu of returning eligible parole violators to prison requires a willingness to accept the additional risks associated with keeping individuals who are proven to be uncooperative in the community. The parole division minimized the risk to public safety by placing less-dangerous parole violators in the programs. However, depending on the program, this supervision or strict control occurred for between 30 days and an average of 45 days, which is significantly less than the average 153 days a parolee would have stayed in prison for parole violations.

Based on our data analysis, of the 2,567 parole violators placed in the SATCU program and 3,175 parole violators placed in the Halfway Back program by December 31, 2004, 128 (5 percent) and 114 (4 percent), respectively, were returned to prison for new convictions during the time they otherwise would have been in prison. Notwithstanding the significance of those crimes to their victims, the percentage of parolees participating in the two programs who were convicted of new crimes is small. An additional 1,732 parole violators placed in the Halfway Back and SATCU programs were returned to prison for committing parole violations during that time. However, the parole division had no benchmarks to determine whether these results were acceptable.

We recommend the parole division consider analyzing the effect programs have had on parolee behavior and use the knowledge it gains from the analyses to make future intermediate sanction programs more effective. The analysis should include the benefits of adding features to make these programs more effective.

Department's Action: Partial corrective action taken.

The parole division indicates that the department's office of research conducted a performance review of the seven parolee programs in October 2006. This review, which used data through June 2006, suggested adjustments to the outcome goals, which the parole division has accepted.

CALIFORNIA DEPARTMENT OF CORRECTIONS

It Needs to Better Ensure Against Conflicts of Interest and to Improve Its Inmate Population Projections

REPORT NUMBER 2005-105, SEPTEMBER 2005

Audit Highlights . . .

Our review of the California Department of Corrections' (department) processing of two no-bid community correctional facility (CCF) contracts and its projections of inmate populations revealed the following:

- Although one CCF contract was never executed, actions taken by two of the contractor's employees who formerly worked for the department may have violated conflict-of-interest laws.***
- The department does not ensure that retired annuitants in designated positions file statements of economic interests.***
- The department, the facility owner, and the potential contractor all incurred costs before the department received approval to proceed with a no-bid contract.***
- Information the department relied upon to determine the need for the no-bid contracts appears accurate.***

continued on next page . . .

California Department of Corrections and Rehabilitation's response as of October 2006

The California Department of Corrections' (department) fiscal year 2003–04 budget did not include funds to continue the contracts for three private community correctional facilities (CCF).

However, in 2004 the department experienced a large unexpected increase in inmate population because parole reform programs were not carried out and because new inmate admissions from counties increased. Since prior population projections had generally projected a stable population through 2009, the department did not expect this large increase. To respond to this situation, the department put thousands of added beds into use, some located in "overcrowding" areas—temporary beds placed in areas that are more difficult to secure, such as gymnasiums and dayrooms. In summer 2004, the Youth and Adult Correctional Agency and the department decided to reactivate two of the closed CCFs, McFarland and Mesa Verde, using one-year, no-bid contracts, while initiating a competitive bidding process for a longer-term solution.

The department's Population Projections Unit (projections unit) generates population projections for time frames that span six fiscal years, monitors and reports on the quality of the projections, and explains inconsistencies between actual and projected populations. The annual population projections correspond with the State's budget cycle and drive the department's annual budget request. The department prepares its budget request using the fall population projection and submits this request to the Department of Finance (Finance) for use in preparing the Governor's Budget. It revises its budget request based on the spring population projection and submits the revision to Finance for inclusion in the May revision of the Governor's Budget. The department also uses these projections to assess the ability of its facilities to house the inmate population over a six-year timeline.

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits evaluate the process the department used to negotiate and enter into two no-bid contracts for private prison facilities to determine whether its policies and procedures are

☑ *The department's inmate population projections are useful for budgeting, but have limited value for longer-range planning, such as determining when to build additional facilities.*

☑ *Because certain practices increase the subjectivity of the department's projections and no documentation of the projection process exists, our statistical expert could not establish the validity of the projection process.*

consistent with and adhere to current laws and regulations, particularly in relation to conflict-of-interest rules. In addition, the audit committee asked us to analyze information the department used in its decision to enter into the two no-bid contracts to determine whether such information was accurate and reliable, to analyze the reasonableness and consistency of its method of tracking and projecting inmate population, and to assess the validity of any cost savings it identified.

Finding #1: The department began incurring costs related to the Mesa Verde contract prior to receiving appropriate approval.

Before awarding a contract without competition, the department must obtain the approval of General Services. Also, as part of the contract award process, after General Services' approval of the request justifying an exemption from competitive bidding, the department operations manual requires contracts to be forwarded to the contractor for signature. This was the process the department used in executing the McFarland contract. However, it sent the Mesa Verde contract to the contractor for signature before obtaining General Services' approval of its justification for exemption. The department later rescinded its request for exemption because of a decline in inmate population and because of conflict-of-interest concerns. It did not notify the contractor by letter that the contract was not fully approved or in effect until General Services gave its final approval. Nevertheless, the department, the facility owner, and the potential contractor all incurred costs before receiving approval from General Services.

We recommended that, to strengthen controls over its processing of no-bid contracts, the department wait until all proper authorities have approved the no-bid contract justification request before sending a contract to a contractor for signature or signing the contract itself.

Department's Action: None.



The department states that its normal contract procedures comply with this recommendation. However, it further states that when timing is critical for procuring essential services, obtaining the contractor's signature in advance helps to expedite the process, but does not, in any way, execute the contract.

Finding #2: Although the department has controls in place to identify conflicts of interest, a conflict may have existed with the unexecuted Mesa Verde contract.

Despite conflict-of-interest disclosure requirements in the contract, Civigenics—the Mesa Verde contractor—did not disclose that two of its employees had worked for the department within the past year. As of July 2005, these same two Civigenics employees were also listed as current retired annuitants available to work at the department.

According to Civigenics officials, the company hired one former high-ranking department employee to develop a strategic plan and the other to help with the reactivation of Mesa Verde. The employment of the two individuals by both the department and Civigenics created potential conflicts of interest that, had the contract been fully executed, could have rendered it void. Moreover, certain contacts between these two individuals and the department during the contract formation process raise the possibility that conflict-of-interest laws were violated even though the contract was never fully executed.

We recommended that the department require key contractor staff to complete statements of economic interests (statements).

Department's Action: None.



The department states it met with the Office of Legal Affairs (OLA) and it reviewed the department's contract requirements as they relate to conflict of interest and found that the department is in compliance with law and the directive given by the Office of the Attorney General in a memorandum on this issue. Nevertheless, while the OLA may have found the department to be in compliance with the law and a directive of the Attorney General's Office, its existing practice was not sufficient to warn it of potential conflicts of interest on the part of key contractor staff.

Finding #3: The department can improve its collection and review of required disclosure forms.

State law requires agencies to adopt a conflict-of-interest code that designates employees in decision-making positions and requires them to file periodic statements. Accordingly, the department has adopted regulations that list the designated positions and spell out the disclosure requirements. Although most of the employees who are assigned to designated positions with a role in developing the CCF contracts completed the required statements, some did not. All 20 department staff who had a role in developing the two facilities contracts we reviewed filed statements covering all or part of 2004, but two retired annuitants associated with one of these contracts did not. Also, the department does not ensure the completeness of the statements employees do file. Four of the 20 employees whose statements we reviewed filled out their statements incorrectly. Because the department does not review all the filed statements for accuracy or completeness, it cannot ensure that its employees in designated positions have met their respective disclosure requirements.

The department's practice of continuing former employees as active retired annuitants when they are not actually working could create confusion about whether its retired annuitants are subject to revolving-door prohibitions or the conflict-of-interest provisions that apply to current employees. According to the department, one of the primary reasons it hires staff who retire at the deputy director level and above as retired annuitants is to provide expert testimony in pending litigation. Typically, the department appoints retired annuitants to one-year terms and will reappoint them in the subsequent year if their services are still needed. However, because of the state hiring freeze in effect during 2001, the former department director issued a memo directing each institution and the department's headquarters personnel office to delete the expiration dates of all currently employed retired annuitants as of December 31, 2001, to eliminate the need to seek formal freeze exemptions approved by Finance each new calendar year. According to the chief of Personnel Services, although as of August 2005, the department is still abiding by its policy of not entering expiration dates on its appointments of retired

annuitants, it plans to ask each division to annually advise personnel services' staff which retired annuitants are no longer working. The department will then separate the identified retired annuitants from state service. However, until it implements this change, the department will continue to be at risk from potential conflicts of interest with its contractors and has no way of knowing if its retired annuitants are still needed.

We recommended that the department:

- Ensure that its retired annuitants in designated positions submit required statements.
- Ensure that statements submitted by staff are complete.
- When appointing retired annuitants, limit such appointments to a one-year period and require annual reappointment.
- Consider contracting with retired staff to provide expert testimony in litigation instead of its current practice of hiring them as retired annuitants.

Department's Action: Partial corrective action taken.

The department states that, as of May 2007 retired annuitants performing duties in designated positions will be required to annually file statements of economic interests. For other staff, the department states that it will perform a cursory review on the cover page of each statement of economic interests to ensure all items are complete. The department further states that it is posting expiration dates on all current retired annuitant appointments, and will enter a 12-month expiration date on all new appointments. Finally, the department is studying the feasibility of contracting with former employees to provide expert testimony in litigation rather than hiring them as retired annuitants.

However, as of October 2006 the department is still working with its technical support staff to develop a database for tracking positions required to file statements of economic interests and, therefore, is unable to conduct a reliable audit reconciling those staff required to file with those that did file.

Finding #4: The cost comparisons the department used to justify the no-bid contracts were incomplete.

Although the information on which the department based its decision to open two CCFs using no-bid contracts appears reasonable, its justification for these contracts included incomplete cost comparisons. The department stated in its justification that the two contracts represented a potential cost savings to the State because the per diem rates for the facilities are less than the daily jail rate of \$59, the maximum the department can reimburse counties for detaining certain state parolees who have violated parole and therefore are being sent back to prison. However, the two costs are not comparable. Because the CCF contract amounts, unlike the daily jail rate, do not include all the costs of housing an inmate, the department's claim of cost savings is misleading. Compared to other CCF contracts in place in 2004, however, the average annual per-bed cost of the two no-bid contracts appears to be within a reasonable range.

We recommended that the department include all its costs when it decides to include cost comparisons in justification requests or state that the cost comparison is incomplete.

Department's Action: Corrective action taken.

The department states that future no-bid contract justifications containing cost comparisons or benchmarks used for housing inmates will be complete.

Finding #5: With high error rates, the department's longer-term projections do not accurately predict its need for inmate housing.

In developing its budgets, the department primarily relies on information from the first two years of a projection, which reflects the period for which the department is preparing a budget. The average error rate of the projection process in the first two years is less than 5 percent and therefore appears reasonable for this purpose. However, because of the time needed to build a new prison, the department also uses projections to assess the sufficiency of its facilities to house future inmate populations. For this assessment the department uses all six years of the projection period. The department's average error rate increases rapidly beginning in the third year, reaching almost 30 percent by the end of the sixth year. Therefore, the department's reliance on its projections in assessing the sufficiency of its facilities and planning future prison construction appears misplaced.

We recommended that, if the department intends to continue using the projections for long-term decision making, such as facility planning, it ensure that it employs statistically valid forecasting methods and consider seeking the advice of experts in selecting and establishing the forecasting methods that will suit its needs.

Department's Action: Pending.

The department states that, as of the end of October 2006, it is working with its contracts staff to establish a public entity agreement with Ohio State University. This is a departure from the department's six-month response, when it stated it was working with the Office of Research to establish an interagency agreement with statistical experts at either the CSU or UC systems to review the existing simulation model and projections process. Frankly, we do not understand why the department feels it necessary to contract with an out-of-state source when such expertise is located in Northern California, which would appear to be a more effective and efficient way to obtain the expert advice it needs.



Finding #6: The department does not properly update its projection data.

The department's projection model uses data from prior experiences to establish the likelihood of certain events occurring at steps along the projection process. For example, at a given point in the simulation model, an inmate hypothetically may have a 40 percent chance of being released on parole, a 50 percent chance of remaining in prison for at least another month, and a 10 percent chance of dying in prison. However, the department does not always properly update the frequencies—or relative percentages of the likelihood of different options occurring—using sufficient historical data. Rather than using a statistical process to develop the frequencies, the department takes the same frequencies used in its previous projection and then updates the

numbers based on analysts' experience and review of the actual data since the last projection. This method increases the possibility of bias entering into the projection. According to our statistical expert, the department cannot support its forecasts using its present methodology.

We recommended that, to increase the accuracy and reliability of its inmate projection, the department update its variable projections with actual information, whenever feasible to do so.

Department's Action: None.

The department states that it will develop a database that will store data and be used to update its variable projections in its simulation model. However, the department also stated that it has not yet started this effort and will not until it hires a retired annuitant in the spring of 2007 to begin work on this project.

Finding #7: Contrary to its policy, the projections unit used speculative estimates in its projections.

At the direction of the department and contrary to its own policy, the projections unit used estimates in its projections that are not based on past experience or that include information from programs whose effects could not be reasonably estimated in several instances. Specifically, in the 2004 spring and fall projections, the department's former chief deputy director of support services directed the projections unit to include the estimated effects of various parole reforms. According to the manager of the projections unit, these estimates were based on changing criteria, and the parole reforms in question had numerous issues that needed to be resolved before any reasonable expectation of population reductions could be estimated. From our review of department policy memos, we noted that criteria such as which inmates were eligible for these programs and the maximum amount of time inmates could be enrolled changed during the time period in which these projections were being made. Nonetheless, department management required the projections unit to include the estimates in its population projections, thus compromising the unit's independence. Without being able to function independently of internal or external pressure to use certain data or arrive at certain conclusions, the credibility of the projections unit's forecasts is diminished.

We recommended that the department disclose when a projection includes estimates for which inadequate historical trend data exists, such as the estimated effects of a new policy, and the specific effect such estimates have on the projection.

Department's Action: Corrective action taken.

The department states that, when a projection includes estimates for which inadequate historical trend data exists, it will publish two projections; one which will be based on historical trends and one which includes the estimates; it will show the impact that the estimates have on the trend projection. An example of this plan can be found in the department's Spring 2005 population projection.

Finding #8: The department failed to obtain information from counties that would have alerted it to rising admissions.

In addition to the unrealized effects of parole reforms, the spring 2004 population projection was also understated because of an unexpected rise in inmate admissions from counties. Because county superior courts sentence felons to state prison, changes in county policies on prosecuting criminals can affect inmate admissions at the state level. Los Angeles County was the primary source of the rising inmate admission rate during this period. According to the department's director, the new chief of police of the city of Los Angeles changed the city's approach to policing, increasing the number of people being sent to prison. However, until recently, the department did not have an effective process in place to communicate with local governments to identify such changes and their effect on the number of inmates being sentenced to prison. The department is developing ways to establish better communications with the counties.

We recommended that the department continue its recent efforts to enhance its communications with local government agencies to better identify changes that may materially affect prison populations.

Department's Action: Pending.

The department states that it is waiting for the California District Attorney's Association to take the next step in an effort to establish contacts with the district attorneys offices in major counties through the development and use of a shared database.

Finding #9: Lack of documentation casts doubt on the validity of the projection process.

To assess the statistical validity of its projection process, our statistical expert met with key department staff to review the documentation of the projection method. However, the department does not have documentation describing its complete projection model, so we were unable to assess its validity. According to our statistical expert, documenting a projection process, including the computer program used, is important so others can evaluate the process and understand its limitations and capabilities. She added that, for staff within the department, such documentation is very valuable for the continuity of the forecasting process when current staff retire or leave. She concluded that data analysis is a constantly evolving process and appropriate documentation is crucial in all stages to continuously improve the analysis as more and more data become available. According to the chief of the branch that includes the projections unit, it is currently revising the projection model and plans to produce documentation for the revised version.

We recommended that the department fully document its projection methodology and model.

Department's Action: Partial corrective action taken.



The department states that it is in the process of writing documentation for its simulation model, and as of October 2006 is about 50 percent complete.

DEPARTMENT OF JUSTICE

The Missing Persons DNA Program Cannot Process All the Requests It Has Received Before the Fee That Is Funding It Expires, and It Also Needs to Improve Some Management Controls

Audit Highlights . . .

Our review of the Department of Justice's Missing Persons DNA Program (missing persons program) revealed the following:

- Created in January 2001, the missing persons program reached full operation in July 2004, which appears reasonable considering the issues it faced in establishing operations.*
- As of February 2005, the missing persons program had received 799 requests and completed DNA analysis for 261 of them, but is unlikely to complete testing for all requests before the fee supporting it expires.*
- It may be too soon to decide whether the existing fee supporting the missing persons program should be made permanent.*
- Several elements of the missing persons program are sound, but its management information and timekeeping databases, which could otherwise serve as valuable management tools, include inaccurate data.*

continued on next page . . .

REPORT NUMBER 2004-114, JUNE 2005

Department of Justice's response as of June 2006

The Joint Legislative Audit Committee requested the Bureau of State Audits to assess the Missing Persons DNA Program (missing persons program) administered by the Department of Justice (Justice), with a focus on determining whether it is meeting its statutory provisions and efficiently using its funds.

Finding #1: The missing persons program has recently reached full operation but will not complete existing work before the fee supporting the program expires.

After the missing persons program was created in January 2001, it faced several challenges in reaching full operation. These challenges included a hiring freeze for state agencies, the extensive training necessary for its staff, and low pay rates compared to other jobs requiring the same skills. Given these challenges, it seems reasonable that it took until July 2004 for the missing persons program to reach full operation. However, as of the end of February 2005, the program had received 799 requests for DNA analysis and 538 were awaiting analysis, which equates to 23 months of work. Program management has acknowledged that it will not be able to complete DNA analysis for all the requests before the fee supporting the missing persons program expires in January 2006.

Although some accumulation of work beyond what can immediately be processed is reasonable, the amount of work the missing persons program has accumulated suggests that in the short term the program does not have the capacity to process all of the requests it receives. In positioning itself for the long term, the program must ensure that its workload estimate is accurate.

Thus far, the program's estimate has been close to the number of requests it has received. However, the program's workload estimate is based on a calendar year 2000 report from Justice's Missing and Unidentified Persons System showing that coroners and local law enforcement agencies submitted 150 reports of unidentified human

☑ *The missing persons program is receiving the funding to which it is entitled and its costs are appropriate for a laboratory to incur.*

remains in that year. More recent information shows that the average number of deceased unidentified persons reported from 2001 through 2004 is 190 per year, 40 more than the program's estimate. In addition, the program's current estimate does not include the number of requests it will receive related to missing persons, including personal articles and DNA supplied by parents and relatives.

To ensure that it is based on the most current data and reflects future program demands, we recommended that the missing persons program review its workload estimate periodically.

Justice's Action: Corrective action taken.

The missing persons program reports that in December 2004 Justice implemented a system for tracking service requests using Justice Trax software. The missing persons program stated that it now has reliable workload statistics on a monthly and yearly basis.

Finding #2: It may be too soon to decide if the existing fee supporting the missing persons program should be made permanent.

Between January 1, 2001, and June 30, 2004, the missing persons program recorded revenues of \$11 million and expenditures of \$7 million in the Missing Persons DNA Data Base Fund (DNA fund). As of June 30, 2004, the program had a fund balance of nearly \$4 million. Justice plans to use the fund balance in the DNA fund to continue operating the program should the \$2 fee end on January 1, 2006, as the California Penal Code, Section 14251, currently requires. Using expenditure data from the first six months of fiscal year 2004–05 to estimate the program's expenditures for the full fiscal year, we estimate that the fund balance is sufficient for the program to operate for more than one year at current staffing and expenditure levels after the fee expires. However, Justice's plan assumes that certain changes will occur that would enable the missing persons program to continue operating using its fund balance, even though the authorization for the DNA fund and the \$2 fee increase on death certificates both end on January 1, 2006. In addition to the missing persons program receiving a fiscal year 2005–06 appropriation, the Department of Finance would have to move the program's appropriation and fund balance to the General Fund. The missing persons program's operations would be halted by June 30, 2006, when its fiscal year 2005–06 appropriation expires, unless legislation continues the necessary fee or the Legislature appropriates any remaining fund balance in a successor fund for fiscal year 2006–07.

Assembly Bill 940 proposes making the \$2 fee increase on death certificates permanent, to fund the missing persons program indefinitely. However, since the missing persons program has amassed a fund balance of \$3.9 million and needs to update its workload estimate, coupled with the fact that the program only recently achieved full operation, it may be

too soon to decide if its funding should be made permanent. Therefore, we recommend that it may be more prudent for the Legislature to extend the \$2 fee increase on death certificates for a defined period of time and then reassess the program's accomplishments and needs.

Legislative Action: Legislation enacted.

Assembly Bill 940 (Chapter 471, Statutes of 2005) was approved by the governor on October 4, 2005. This bill extends the fee supporting the program until January 1, 2010.

Finding #3: Several elements of the missing persons program are sound.

In creating the missing persons program, Justice has put into place several sound elements. Specifically, the program's staffing approach and training levels appear appropriate, it has successfully educated local law enforcement agencies about its program, and it has made reasonable efforts to obtain federal funding.

Missing persons program staff train for nearly two years before they are qualified to work with minimal direct supervision. Although the timeline is lengthy, the training process ensures that staff meet accreditation requirements and industry standards. In addition, its training process is comparable to that of laboratories doing similar work.

At its inception in 2001, the missing persons program did not have an existing pool of requests on which to begin analysis. By February 28, 2005, it had received 799 requests from local law enforcement agencies in 50 of California's 58 counties, such as Los Angeles, Orange, and San Diego. This suggests that the program has been effective in making its mission and services known to local law enforcement agencies. The program has used a combination of information bulletins, presentations at industry conferences, and a training video to communicate its mission and services.

Section 14251(a) of the California Penal Code states that the \$2 fee increase on death certificates would remain in effect until January 1, 2006, or until federal funds became available, whichever is sooner. Thus, it appears that the Legislature contemplated a real possibility of federal funds to operate a missing persons DNA database. Although our review disclosed that some federal grants relate to DNA analysis, these funding opportunities are not specifically earmarked for DNA analysis of missing persons or unidentified human remains. Nevertheless, according to Justice, its process to identify appropriate federal grants includes sending representatives to the National Institute of Justice's annual meeting where future grant opportunities are discussed and using its budget office to research and coordinate efforts to identify federal funding.

Finding #4: The missing persons program could not provide sufficient documentation to support that it adheres to the priorities its advisory committee established.

The program's advisory committee, consisting of coroners, law enforcement officials, and other stakeholders, set up priorities for the program for processing DNA requests. However, we could not determine if the program is following the guidelines, because its list for documenting the priority it assigns to a request and the reasons why is incomplete. The list is designed to capture the following information: the request number; whether the request concerns a child; the cause of death, if known; whether the request concerns a specific missing person; and comments about the materials available for analysis, for example, a tooth, a femur, or hair. Despite containing

these categories, the list does not provide enough information to determine the request's priority, because it does not state the priority that was assigned and does not include all of the priority categories contained in the guidelines.

To ensure that the missing persons program is completing the most critical requests first and that its limited resources are focused on the highest-priority requests, it should amend its priority list to include all of the information used to determine the priority assigned to each request.

Justice's Action: Corrective action taken.

The missing persons program told us that it has included the priority code that is consistent with the guidelines developed by its advisory committee on its priority list for case assignments. The missing persons program stated that each case is maintained in the case assignments list along with its priority code so that the priority assigned to any particular case can be determined. Further, the missing persons program maintains the case assignment list on its computer network such that any laboratory management personnel can access the list and make staff assignments.

Finding #5: Some of the data the program's management information and timekeeping databases contain are not reliable.

The missing persons program uses a variety of databases, two of which contained data we believed would be relevant to the audit. One is a database the program uses to assist it in tracking and storing information related to requests for DNA analysis, and the other is one it uses for staff timekeeping. However, through our testing we determined that the data contained in the databases are inaccurate and not reliable for our audit purposes. The database the program uses to track requests contains some inaccurate dates and the timekeeping database lacks controls to ensure that approved time records are not changed, was missing a staff member's time, and included some time that was not recorded properly.

To make certain that it has effective tools to help manage and measure the program, missing persons program management should take the necessary steps to ensure that its management information and timekeeping databases contain accurate and reliable data.

Justice's Action: Corrective action taken.

The missing persons program reported that it has addressed the inaccuracies in its management information database. In addition, in its one-year response to our audit report, the missing persons program stated that its management information database was upgraded and new features of the database allow for better case and DNA analysis requests tracking. Also, the upgraded database allows the missing persons program to access more reports including workload statistics and unassigned, assigned, and complete DNA analysis requests. The missing persons program concurred with our evaluation of its timekeeping system and reported that Justice selected the Branch Time Reporting system to replace the current timekeeping system. The program noted that the new timekeeping system has many built-in security features including employee lock out following supervisory review. In addition, the new timekeeping system provides numerous tracking features.

Finding #6: Justice is receiving the revenues earmarked for the program and the program's expenditures appear reasonable.

According to Justice's accounting records, revenues for the program are \$3 million per year. This amount substantially agrees with the fees due based on the number of death certificates issued for fiscal years 2001–02 through 2003–04.

We reviewed the program's expenditures for these same three fiscal years. Its facilities costs are the most significant expenditures, totaling \$1.4 million for rent and \$2 million for tenant improvements. However, these expenditures appear reasonable considering the program's space needs, the tenant improvements made, and the methodology Justice follows to determine the program's share of facilities costs. Finally, Justice's methodologies for apportioning personal services costs seem reasonable and the program's expenditures for other operating expense and equipment costs seem appropriate for a laboratory to incur.

DEPARTMENT OF INDUSTRIAL RELATIONS

Investigations of Improper Activities by State Employees, January 2006 Through June 2006

INVESTIGATION I2006-0708 (I2006-2), SEPTEMBER 2006

Department of Industrial Relations' response as of September 2006

Investigative Highlight . . .

Used bereavement leave for work missed while incarcerated.

We investigated and substantiated an allegation that a Department of Industrial Relations (Industrial Relations) employee improperly used bereavement leave.

Finding: An Industrial Relations' employee used bereavement leave while she was in jail.

An employee charged and received payment for 16 hours of bereavement leave on her official time report and cited the death of her aunt as the reason for her absence. However, public records show that the employee was incarcerated in a Los Angeles County jail for those two days. By charging bereavement leave for hours she missed due to her incarceration, the employee improperly claimed and received \$282 for 16 hours she did not work, in violation of state law.

Industrial Relations' Action: Corrective action taken.

Industrial Relations served the employee with a five-day suspension without pay. In addition, Industrial Relations set up an accounts receivable to recover the 16 hours of pay that was improperly charged as bereavement leave.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

It Relied Heavily on Blue Shield of California's Exclusive Provider Network Analysis, an Analysis That Is Reasonable in Approach but Includes Some Questionable Elements and Possibly Overstates Estimated Savings

Audit Highlights . . .

Our review of the decision by the California Public Employees' Retirement System (CalPERS) board of administration (board) in May 2004 to approve an exclusive provider network for CalPERS members in the Blue Shield of California (Blue Shield) health maintenance organization (HMO) found the following:

- Our consultants found that many components of Blue Shield's analysis appear reasonable but some questionable elements exist such as using claim data from non-CalPERS sources.*
- Blue Shield's original savings estimate did not incorporate a health system's financial terms that were expected to produce substantial savings in 2005 only if the board did not adopt the exclusive provider network.*

continued on next page . . .

REPORT NUMBER 2004-123, MARCH 2005

California Public Employees' Retirement System's response as of March 2006

The Joint Legislative Audit Committee requested the Bureau of State Audits to examine the California Public Employees' Retirement System (CalPERS) decision to discontinue contracting with certain hospitals through the Blue Shield of California (Blue Shield) health maintenance organization (HMO) provider network. Our consultants found that many components of Blue Shield's analysis appear reasonable but some questionable elements exist such as using claim data from non-CalPERS sources. In addition, Blue Shield's original savings estimate did not incorporate a health system's financial terms that were expected to produce substantial savings in 2005 only if the board did not adopt the exclusive provider network. Also, Blue Shield's estimate of \$31.4 million in savings does not take into consideration the impact of members leaving its HMO provider network and joining other health care plans. Further, Blue Shield did not adequately address a recommendation to investigate differences in emergency room assumptions for one health system. According to our consultant, Blue Shield's hospital savings estimate of \$20.6 million could drop to only \$8.9 million if the model-review actuary's assumptions were used. Moreover, the CalPERS board, health benefits committee (committee), and health benefits branch staff relied primarily on Blue Shield's summary of its analyses and its presentations in deciding to approve the exclusive provider network. Although a model-review actuary was hired to, among other things, review Blue Shield's cost savings projections, he was unable to express an opinion on the savings estimate of \$36.3 million related to the 38 hospitals; thus, his report could not provide a credible basis for the CalPERS board to evaluate the savings estimate. Finally, in one instance, our consultant found that Blue Shield deviated from its original criteria for excluding hospitals from the network.

- ☑ *Blue Shield's estimate of \$31.4 million in savings does not take into consideration the impact of members leaving its HMO provider network and joining other health-care plans.*
- ☑ *Blue Shield did not adequately address a recommendation to investigate differences in emergency room assumptions for one health system. According to our consultant, Blue Shield's hospital savings estimate of \$20.6 million could drop to only \$8.9 million if the model-review actuary's assumptions were used.*
- ☑ *The CalPERS board, health benefits committee, and health benefits branch staff relied primarily on Blue Shield's summary of its analyses and its presentations in deciding to approve the exclusive provider network.*
- ☑ *Although a model-review actuary was hired to, among other things, review Blue Shield's cost savings projections, he was unable to express an opinion on the savings estimate of \$36.3 million related to the 38 hospitals; thus, his report could not provide a credible basis for the CalPERS board to evaluate the savings estimate.*
- ☑ *In one instance, our consultant found that Blue Shield deviated from its original criteria for excluding hospitals from the network.*

Finding #1: CalPERS relied primarily on Blue Shield's summary of its analyses and presentations in making the decision to exclude hospitals.

A provision of the contract between CalPERS and Blue Shield specifies that Blue Shield cannot disclose information to CalPERS that would cause it to breach the terms of any contract to which it is a party. According to Blue Shield, the terms of the contract between it and providers in its network specifically prohibit the disclosure of certain information, including rates of payment. Consequently, CalPERS health benefits branch staff did not have access to hospital rates, nor could they review Blue Shield's cost model. As a result, CalPERS was unable to verify the accuracy of Blue Shield's cost comparison data.

We recommended that the Legislature consider enacting legislation that would allow CalPERS, during its contract negotiation process, to obtain relevant documentation supporting any analyses it will use to make decisions that materially affect the members of the health benefits program established by the Public Employees' Medical and Hospital Care Act.

Legislative Action: Unknown.

Finding #2: CalPERS did not fully consider all of the findings and recommendations made by the actuary hired to perform a third-party review prior to approving the exclusive provider network.

CalPERS health benefits branch staff directed Blue Shield to hire an independent actuary (model-review actuary) to conduct a third-party review to resolve differences between Blue Shield's and a health system's analyses. Blue Shield's contract with the model-review actuary also required him to review the cost savings projections for the exclusive provider network. The model-review actuary issued his final report to Blue Shield and CalPERS in April 2004, which contained numerous findings and recommendations. Although the board and committee discussed Blue Shield's savings estimate in meetings held before the board voted to approve the exclusive provider network in May 2004, our review of the transcripts found that they did not discuss all of the model-review actuary's findings and recommendations or the impact of the findings and recommendations on the CalPERS board's decision. Without fully addressing all of the concerns raised by the model-review actuary, CalPERS had no assurance from an independent source that Blue Shield's savings estimate, as well as other aspects of its model, were accurate.

We recommended that, to ensure its decisions are in the best interests of CalPERS members, CalPERS should require its health benefits branch staff to evaluate fully the findings and recommendations of third-party reviews and present their results to the board and committee.

CalPERS' Action: Corrective action taken.

CalPERS stated that, effective September 1, 2005, it implemented procedures to formalize its procedures for coordinating, analyzing, and reporting on third-party reviews. These procedures require CalPERS' management to appoint a third-party review coordinator to oversee reviews. The procedures also require the coordinator to examine the scope of work and contract for third-party reviews; act as the liaison between CalPERS' management and reviewing entities; monitor the reviews; evaluate draft third-party review reports; and analyze and summarize final third-party review reports, including any problems or limitations in the work. Further, the procedures require CalPERS' management to convey the results of third-party reviews and the coordinator's summaries to the CalPERS board or one of its committees.

APPENDIX A

Summary of Recommendations for Legislative Consideration by Policy Area

Table A presents a summary of the recommendations the Bureau of State Audits made during the 2005–06 legislative session for the Legislature to consider or for the auditee to seek legislative changes. Reports describing these recommendations are also identified in this table. For the background and issues relating to these recommendations, refer to the page numbers listed next to each recommendation.

TABLE A

Recommendations Directed to the Legislature

Policy Area/Report Number and Title	Page(s)	Recommendation
Appropriations		
2005-136, Military Department: <i>It Has Had Problems With Inadequate Personnel Management and Improper Organizational Structure and Has Not Met Recruiting and Facility Maintenance Requirements</i>	18-20	The California Military Department should go through the legislative process in order to be able to provide incentives that will encourage citizens to join the California National Guard, and it should work with the Department of Finance and the Legislature to establish a baseline budget for maintaining and repairing California’s armories.
Business and Professions		
2005-118, Emergency Preparedness: <i>California’s Administration of Federal Grants for Homeland Security and Bioterrorism Preparedness Is Hampered by Inefficiencies and Ambiguity</i>	39	With the governor, streamline the State’s emergency preparedness structure, and include in this process consideration of establishing one state entity to be responsible for emergency preparedness, including preparedness for emergencies caused by terrorist acts. Additionally, statutorily establish Homeland Security in law as either a stand-alone entity or a division within Emergency Services, and if creating Homeland Security as a stand-alone entity, statutorily define the relationship between Homeland Security and Emergency Services. Note: AB 38 (introduced 12/4/06) partially addresses the above recommendation by establishing the Office of Homeland Security as a division within the Office of Emergency Services
2005-108, Department of Industrial Relations: <i>Its Division of Apprenticeship Standards Inadequately Oversees Apprenticeship Programs</i>	42	To effectively implement program audits, we recommended the Department of Industrial Relations’ Division of Apprenticeship Standards request that the Legislature amend auditing requirements to allow it to select programs for audit using a risk-based approach.

continued on next page

Policy Area/Report Number and Title	Page(s)	Recommendation
2005-136, Military Department: <i>It Has Had Problems With Inadequate Personnel Management and Improper Organizational Structure and Has Not Met Recruiting and Facility Maintenance Requirements</i>	18-20	The California Military Department should go through the legislative process in order to be able to provide incentives that will encourage citizens to join the California National Guard, and it should work with the Department of Finance and the Legislature to establish a baseline budget for maintaining and repairing California's armories.
2005-129, Department of Social Services: <i>In Rebuilding Its Child Care Program Oversight, the Department Needs to Improve Its Monitoring Efforts and Enforcement Actions</i>	55	The Department of Social Services should consider proposing statutes or regulations requiring it to assess additional civil penalties on child care homes for health and safety violations to improve enforcement actions.
2005-120, California Student Aid Commission: <i>Changes in the Federal Family Education Loan Program, Questionable Decisions, and Inadequate Oversight Raise Doubts About the Financial Stability of the Student Loan Program</i>	60-62	Closely monitor the California Student Aid Commission (Student Aid) and EDFUND to ensure that they are able to remain competitive with other Federal Family Education Loan Program (FFEL program) guaranty agencies; the Operating Fund to ensure that the FFEL program is generating a sufficient operating surplus so that it can supplement funding for Student Aid's other services and programs; and Student Aid's progress toward completing critical tasks, including the renegotiation of its voluntary flexible agreement with the U.S. Department of Education and the development of a business diversification plan. Additionally, we recommended that if EDFUND is unable to generate a sufficient operating surplus, the Legislature should require Student Aid to dissolve EDFUND and contract with another guaranty agency to administer the FFEL program or should reconsider the need for a state-designated guaranty agency.
2004-134, State Athletic Commission: <i>The Current Boxers' Pension Plan Benefits Only a Few and Is Poorly Administered</i>	103	Reconsider the need for a retired boxers' pension plan or decrease vesting requirements.
2004-033, Pharmaceuticals: <i>State Departments That Purchase Prescription Drugs Can Further Refine Their Cost Savings Strategies</i>	118	Enact legislation to allow the California Public Employees' Retirement System to obtain relevant documentation to ensure it is receiving all rebates to which it is entitled to lower the prescription drug cost of the health benefits program established by the Public Employees' Medical and Hospital Care Act.
2004-138, Department of Parks and Recreation: <i>It Needs to Improve Its Monitoring of Local Grants and Better Justify Its Administrative Charges</i>	128	Specifically define what is to be accomplished with any General Fund grants appropriated in the future to ensure grant funds are spent as intended.
2004-115, The State's Offshore Contracting: <i>Uncertainty Exists About Its Prevalence and Effects</i>	139	Grant the Department of General Services the ability to require state contractors to disclose information detailing portions of the project that subcontractors or employees outside the United States will perform. Note: AB 524 (2005) addressing this recommendation was vetoed on September 29, 2005.

Policy Area/Report Number and Title	Page(s)	Recommendation
Education		
2005-133, Department of Education: <i>Its Mathematics and Reading Professional Development Program Has Trained Fewer Teachers Than Originally Expected</i>	144-145	Redefine the expectations for the Mathematics and Reading Professional Development Program (program) and require the Department of Education (department) to provide meaningful data against which to evaluate program success. Additionally, the department should seek legislation authorizing it to make program payments to school districts without Board of Education approval.
2005-137, California Public Schools: <i>Compliance With Translation Requirements Is High for Spanish but Significantly Lower for Some Other Languages</i>	150	The Department of Education should seek legislation to amend the law to allow parents to waive the requirement that they receive materials from their child's public school translated into their primary language.
2005-104, Department of Education: <i>Its Flawed Administration of the California Indian Education Center Program Prevents It From Effectively Evaluating, Funding, and Monitoring the Program</i>	160	Require the Department of Education to submit annual or biannual reports on the California Indian Education Center program (program) that monitor the progress of the program and supplement a report submitted on this topic in late 2005. Note: Although SB 1710 (2006) increased the department's statutorily defined oversight duties and mechanisms, it did not directly address the above recommendation.
2004-125, Department of Health Services: <i>Participation in the School-Based Medi-Cal Administrative Activities Program Has Increased, but School Districts Are Still Losing Millions Each Year in Federal Reimbursements</i>	168-169	The Department of Health Services (Health Services) should seek changes in the law to eliminate the use of local governmental agencies in the school-based Medi-Cal Administrative Activities Program and to authorize Health Services to require that school districts that choose to use a vendor for program assistance use one that is selected by a consortium through a competitive process. Note: SB 496 (2005)—introduced but not passed—did not directly address these recommendations but would have created a committee to advise the department with respect to the above claims process.
2004-120, Department of Education: <i>School Districts' Inconsistent Identification and Redesignation of English Learners Cause Funding Variances and Make Comparisons of Performance Outcomes Difficult</i>	172	The Department of Education should work in conjunction with relevant parties to establish required designation and redesignation criteria for English learners, seeking legislation as necessary.
Governmental Organization		
2005-118, Emergency Preparedness: <i>California's Administration of Federal Grants for Homeland Security and Bioterrorism Preparedness Is Hampered by Inefficiencies and Ambiguity</i>	39	With the governor, streamline the State's emergency preparedness structure, and include in this process consideration of establishing one state entity to be responsible for emergency preparedness, including preparedness for emergencies caused by terrorist acts. Additionally, statutorily establish Homeland Security in law as either a stand-alone entity or a division within Emergency Services, and if creating Homeland Security as a stand-alone entity, statutorily define the relationship between Homeland Security and Emergency Services. Note: AB 38 (introduced 12/4/06) partially addresses the above recommendation by establishing the Office of Homeland Security as a division within the Office of Emergency Services.

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Policy Area/Report Number and Title	Page(s)	Recommendation
2005-136, Military Department: <i>It Has Had Problems With Inadequate Personnel Management and Improper Organizational Structure and Has Not Met Recruiting and Facility Maintenance Requirements</i>	18-20	The California Military Department should go through the legislative process in order to be able to provide incentives that will encourage citizens to join the California National Guard, and it should work with the Department of Finance and the Legislature to establish a baseline budget for maintaining and repairing California's armories.
2004-126, Off-Highway Motor Vehicle Recreation Program: <i>The Lack of a Shared Vision and Questionable Use of Program Funds Limit Its Effectiveness</i>	192-194	Require the Off-Highway Motor Vehicle Recreation Commission (commission) to report annually on its grants and cooperative agreements program awards, clarify its intent for land on which Conservation and Enforcement Services Account restoration funds are spent, and clarify the allowable uses of the Off-Highway Motor Vehicle Trust Fund. Additionally, the Off-Highway Motor Vehicle Recreation Division and commission should evaluate current spending and, if necessary, seek legislation to adjust such restrictions to support a balanced Off-Highway Motor Vehicle Recreation Program.

Health and Human Services

2005-118, Emergency Preparedness: <i>California's Administration of Federal Grants for Homeland Security and Bioterrorism Preparedness Is Hampered by Inefficiencies and Ambiguity</i>	39	<p>With the governor, streamline the State's emergency preparedness structure, and include in this process consideration of establishing one state entity to be responsible for emergency preparedness, including preparedness for emergencies caused by terrorist acts. Additionally, statutorily establish Homeland Security in law as either a stand-alone entity or a division within Emergency Services, and if creating Homeland Security as a stand-alone entity, statutorily define the relationship between Homeland Security and Emergency Services. With the governor, streamline the State's structure for emergency response and define this structure in statute.</p> <p>Note: AB 38 (introduced 12/4/06) partially addresses the above recommendation by establishing the Office of Homeland Security as a division within the Office of Emergency Services</p>
2005-129, Department of Social Services: <i>In Rebuilding Its Child Care Program Oversight, the Department Needs to Improve Its Monitoring Efforts and Enforcement Actions</i>	55	The Department of Social Services should consider proposing statutes or regulations requiring it to assess additional civil penalties on child care homes for health and safety violations to improve enforcement actions.
2004-125, Department of Health Services: <i>Participation in the School-Based Medi-Cal Administrative Activities Program Has Increased, but School Districts Are Still Losing Millions Each Year in Federal Reimbursements</i>	168-169	<p>The Department of Health Services (Health Services) should seek changes in the law to eliminate the use of local governmental agencies in the school-based Medi-Cal Administrative Activities Program and to authorize Health Services to require that school districts that choose to use a vendor for program assistance use one that is selected by a consortium through a competitive process.</p> <p>Note: SB 496 (2005)—introduced but not passed—did not directly address these recommendations but would have created a committee to advise the department with respect to the above claims process.</p>

Policy Area/Report Number and Title	Page(s)	Recommendation
2004-033, Pharmaceuticals: <i>State Departments That Purchase Prescription Drugs Can Further Refine Their Cost Savings Strategies</i>	118	Enact legislation to allow the California Public Employees' Retirement System to obtain relevant documentation to ensure it is receiving all rebates to which it is entitled to lower the prescription drug cost of the health benefits program established by the Public Employees' Medical and Hospital Care Act.
Judiciary		
2005-130, Batterer Intervention Programs: <i>County Probation Departments Could Improve Their Compliance With State Law, but Progress in Batterer Accountability Also Depends on the Courts</i>	206-207	Consider revising attendance provisions and the 18-month completion requirement on batterer intervention programs to be better aligned with what local probation departments and courts indicate is a reasonable standard. Additionally, if it is the Legislature's intent that individuals who commit domestic violence be consistently sentenced to 52 weeks of batterer intervention, enact statutory provisions that would not allow the courts to delay sentencing so that batterers complete a lesser number of program sessions.
Labor, Employment, and Industrial Relations		
2005-108, Department of Industrial Relations: <i>Its Division of Apprenticeship Standards Inadequately Oversees Apprenticeship Programs</i>	42	To effectively implement program audits, we recommended the Department of Industrial Relations' Division of Apprenticeship Standards (division) request that the Legislature amend auditing requirements to allow it to select programs for audit using a risk-based approach.
Local Government		
2005-130, Batterer Intervention Programs: <i>County Probation Departments Could Improve Their Compliance With State Law, but Progress in Batterer Accountability Also Depends on the Courts</i>	206-207	Consider revising attendance provisions and the 18-month completion requirement on batterer intervention programs to be better aligned with what local probation departments and courts indicate is a reasonable standard. Additionally, if it is the Legislature's intent that individuals who commit domestic violence be consistently sentenced to 52 weeks of batterer intervention, enact statutory provisions that would not allow the courts to delay sentencing so that batterers complete a lesser number of program sessions.
Natural Resources, Parks, Wildlife		
2004-126, Off-Highway Motor Vehicle Recreation Program: <i>The Lack of a Shared Vision and Questionable Use of Program Funds Limit Its Effectiveness</i>	192-194	Require the Off-Highway Motor Vehicle Recreation Commission (commission) to report annually on its grants and cooperative agreements program awards, clarify its intent for land on which Conservation and Enforcement Services Account restoration funds are spent, and clarify the allowable uses of the Off-Highway Motor Vehicle Trust Fund. Additionally, the Off-Highway Motor Vehicle Recreation Division and commission should evaluate current spending and, if necessary, seek legislation to adjust such restrictions to support a balanced Off-Highway Motor Vehicle Recreation Program.

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Policy Area/Report Number and Title	Page(s)	Recommendation
2004-138, Department of Parks and Recreation: <i>It Needs to Improve Its Monitoring of Local Grants and Better Justify Its Administrative Charges</i>	128	Specifically define what is to be accomplished with any General Fund grants appropriated in the future to ensure grant funds are spent as intended.
Privacy and Public Safety		
2005-130, Batterer Intervention Programs: <i>County Probation Departments Could Improve Their Compliance With State Law, but Progress in Batterer Accountability Also Depends on the Courts</i>	206-207	Consider revising attendance provisions and the 18-month completion requirement on batterer intervention programs to be better aligned with what local probation departments and courts indicate is a reasonable standard. Additionally, if it is the Legislature's intent that individuals who commit domestic violence be consistently sentenced to 52 weeks of batterer intervention, enact statutory provisions that would not allow the courts to delay sentencing so that batterers complete a lesser number of program sessions.
2005-118, Emergency Preparedness: <i>California's Administration of Federal Grants for Homeland Security and Bioterrorism Preparedness Is Hampered by Inefficiencies and Ambiguity</i>	39	With the governor, streamline the State's emergency preparedness structure, and include in this process consideration of establishing one state entity to be responsible for emergency preparedness, including preparedness for emergencies caused by terrorist acts. Additionally, statutorily establish Homeland Security in law as either a stand-alone entity or a division within Emergency Services, and if creating Homeland Security as a stand-alone entity, statutorily define the relationship between Homeland Security and Emergency Services. Note: AB 38 (introduced 12/4/06) partially addresses the above recommendation by establishing the Office of Homeland Security as a division within the Office of Emergency Services
2005-136, Military Department: <i>It Has Had Problems With Inadequate Personnel Management and Improper Organizational Structure and Has Not Met Recruiting and Facility Maintenance Requirements</i>	18-20	The California Military Department should go through the legislative process in order to be able to provide incentives that will encourage citizens to join the California National Guard, and it should work with the Department of Finance and the Legislature to establish a baseline budget for maintaining and repairing California's armories.
2005-129, Department of Social Services: <i>In Rebuilding Its Child Care Program Oversight, the Department Needs to Improve Its Monitoring Efforts and Enforcement Actions</i>	55	The Department of Social Services should consider proposing statutes or regulations requiring it to assess additional civil penalties on child care homes for health and safety violations to improve enforcement actions.
Public Employment, Retirement, and Social Security		
2005-136, Military Department: <i>It Has Had Problems With Inadequate Personnel Management and Improper Organizational Structure and Has Not Met Recruiting and Facility Maintenance Requirements</i>	18-20	The California Military Department should go through the legislative process in order to be able to provide incentives that will encourage citizens to join the California National Guard, and it should work with the Department of Finance and the Legislature to establish a baseline budget for maintaining and repairing California's armories.

Policy Area/Report Number and Title	Page	Recommendation
<p>2005-120, California Student Aid Commission: <i>Changes in the Federal Family Education Loan Program, Questionable Decisions, and Inadequate Oversight Raise Doubts About the Financial Stability of the Student Loan Program</i></p>	60-62	<p>Closely monitor the California Student Aid Commission (Student Aid) and EDFUND to ensure that they are able to remain competitive with other Federal Family Education Loan Program (FFEL program) guaranty agencies; the Operating Fund to ensure that the FFEL program is generating a sufficient operating surplus so that it can supplement funding for Student Aid's other services and programs; and Student Aid's progress toward completing critical tasks, including the renegotiation of its voluntary flexible agreement with the U.S. Department of Education and the development of a business diversification plan. Additionally, we recommended that if EDFUND is unable to generate a sufficient operating surplus, the Legislature should require Student Aid to dissolve EDFUND and contract with another guaranty agency to administer the FFEL program or should reconsider the need for a state-designated guaranty agency.</p>
<p>2004-033, Pharmaceuticals: <i>State Departments That Purchase Prescription Drugs Can Further Refine Their Cost Savings Strategies</i></p>	118	<p>Enact legislation to allow the California Public Employees' Retirement System to obtain relevant documentation to ensure it is receiving all rebates to which it is entitled to lower the prescription drug cost of the health benefits program established by the Public Employees' Medical and Hospital Care Act.</p>
<p>2004-123, California Public Employees' Retirement System: <i>It Relied Heavily on Blue Shield of California's Exclusive Provider Network Analysis, an Analysis That Is Reasonable in Approach but Includes Some Questionable Elements and Possibly Overstates Estimated Savings</i></p>	260	<p>Enact legislation to allow the California Public Employees' Retirement System, during its contract negotiation process, to obtain relevant documentation supporting any analyses it will use to make decisions that materially affect the members of the health benefits program established by the Public Employees' Medical and Hospital Care Act.</p>

APPENDIX B

Summary of Monetary Benefits Identified In Audit Reports Released From July 1, 2001, Through December 31, 2006

We estimate that auditees could have realized more than \$953 million of monetary benefits during the period July 1, 2001, through December 31, 2006, if they implemented our recommendations. Table B provides a brief description of the monetary benefits we found such as cost recoveries, cost savings, and increased revenues. Finally, many of the monetary benefits we have identified are not only one-time benefits; they are monetary benefits that could be realized each year for many years to come.

TABLE B

Monetary Benefits July 1, 2001, Through December 31, 2006

Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit
July 1, 2006, through December 31, 2006		
I2006-2 (Allegation I2006-0663) (September 2006)	Department of Forestry and Fire Protection: <i>Investigations of Improper Activities by State Employees</i> Cost Recovery —Between January 2004 and December 2005, an employee with the Department of Forestry and Fire Protection improperly claimed \$17,904 in wages for 672 hours he did not work in violation of state law prohibiting individuals from intentionally submitting false claims for payment.	\$18,000
	Annualized carry forward from prior fiscal years:	<u>\$191,742,000</u>
2001-102	Department of Insurance Conservation and Liquidation Office	300,000
2001-107	Port of Oakland	7,500,000
2001-108	California Department of Corrections	733,000
2001-120	School Bus Safety II	44,300,000
2001-128	Enterprise Licensing Agreement	8,120,000
2002-101	California Department of Corrections	29,000,000
2002-009	California Energy Markets	29,000,000
2002-118	Department of Health Services	20,000,000
2003-125	California Department of Corrections	20,700,000
2003-124	Department of Health Services	4,600,000
I2004-2	Department of Health Services	9,000
I2004-2	Military Department	64,000

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Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit
2004-105	California Department of Corrections	290,000
2004-033	Pharmaceuticals	5,100,000*
12005-1	California Department of Corrections	119,000
2004-113	Department of General Services	3,036,000
2004-125	Department of Health Services	10,300,000
2004-134	State Athletic Commission	33,000
12006-1	California Department of Corrections and Rehabilitation	193,000
12006-1	Department of Fish and Game	8,300,000
2005-120	California Student Aid Commission	45,000
Totals for July 1, 2006, through December 31, 2006		\$191,760,000
July 1, 2005, through June 30, 2006		
2004-113 (July 2005)	Department of General Services: Opportunities Exist Within the Office of Fleet Administration to Reduce Costs <i>Cost Savings/Avoidance</i> —The Department of General Services (General Services) expects that the new, more competitive contracts it awarded for January 2006 through December 2008 should save the State about \$3 million each year. <i>Increased Revenue</i> —General Services identified 49 parkers it was not previously charging. By charging these parkers, General Services will experience increased revenue totaling \$36,000 per year. <i>Cost Recovery</i> —General Services reports it has recovered or established a monthly payment plan to recover \$45,000 in previously unpaid parking fees.	\$1,581,000
2004-134 (July 2005)	State Athletic Commission: The Current Boxers' Pension Plan Benefits Only a Few and Is Poorly Administered <i>Increased Revenue</i> —If the commission raises the ticket assessment to meet targeted pension contributions as required by law, we estimate it will collect an average of \$33,300 more per year.	\$33,000
2004-125 (August 2005)	Department of Health Services: Participation in the School-Based Medi-Cal Administrative Activities Program Has Increased, but School Districts Are Still Losing Millions Each Year in Federal Reimbursements <i>Increased Revenue</i> —We estimate that California school districts would have received at least \$53 million more in fiscal year 2002–03 if all school districts had participated in the program and an additional \$4 million more if certain participating schools had fully used the program. A lack of program awareness was among the reasons school districts cited for not participating. By stepping up outreach, we believe more schools will participate in the program and revenues will continue to increase. However, because participation continued to increase between fiscal years 2002–03 and 2004–05, the incremental increase in revenue will be less than it was in fiscal year 2002–03. Taking into account this growth in participation and using a trend line to estimate the resulting growth in revenues, we estimate that revenues will increase by about \$10.3 million per year beginning in fiscal year 2005–06.	\$10,300,000
2004-126 (August 2005)	Off-Highway Motor Vehicle Recreation Program: The Lack of a Shared Vision and Questionable Use of Program Funds Limits Its Effectiveness <i>Cost Recovery</i> —Of the \$566,000 in grant advances we identified as outstanding from Los Angeles County, the division reports receiving a \$226,000 refund and determining that the remaining \$340,000 was used in accordance with grant guidelines.	\$226,000
12005-2 (Allegation 12004-0710) (September 2005)	California Military Department: Investigations of Improper Activities by State Employees <i>Cost Recovery</i> —A supervisor at the Military Department embezzled \$132,523 in public funds; a court has subsequently ordered restitution of these funds.	\$133,000

Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit																														
I2005-2 (Allegations I2004-0649, I2004-0681, I2004-0789) (September 2005)	<p>California Department of Corrections: Investigations of Improper Activities by State Employees</p> <p><u>Cost Recovery</u>—The Department of Corrections (Corrections) failed to properly account for the time that employees used when released from their regular job duties to perform union-related activities. In addition to recovering past payments totaling \$397,161, Corrections can save \$192,500 annually by discontinuing this practice.</p>	\$590,000																														
I2006-1 (Allegation I2005-0781) (March 2006)	<p>California Department of Corrections and Rehabilitation: Investigations of Improper Activities by State Employees</p> <p><u>Cost Recovery</u>—The Department of Corrections and Rehabilitation failed to exercise its management controls, resulting in gifts of public funds of \$17,164 in improper holiday accruals and \$49,094 in leave not charged.</p>	\$66,000																														
I2006-1 (Allegations I2005-0810, I2005-0874, I2005-0929) (March 2006)	<p>Department of Forestry and Fire Protection: Investigations of Improper Activities by State Employees</p> <p><u>Cost Recovery</u>—Several employees of the Department of Forestry and Fire Protection received \$61,466 in improper overtime payments.</p>	\$61,000																														
I2006-1 (Allegations I2004-0983, I2005-1013) (March 2006)	<p>Victim Compensation and Government Claims Board and Department of Corrections and Rehabilitation: Investigations of Improper Activities by State Employees</p> <p><u>Cost Recovery</u>—The Department of Corrections and Rehabilitation (Corrections) improperly awarded payments to a physician at Corrections totaling \$25,950.</p>	\$26,000																														
I2006-1 (Allegation I2004-1057) (March 2006)	<p>Department of Fish and Game: Investigations of Improper Activities by State Employees</p> <p><u>Increased Revenue</u>—The Department of Fish and Game allowed several state employees and volunteers to reside in state-owned homes without charging them rent, consequently providing gifts of public funds. A subsequent housing review conducted by the Department of Personnel Administration demonstrated that all 13 state departments that own employee housing may be underreporting or failing to report housing fringe benefits. As a result, the State could increase revenues as much as \$8.3 million by charging fair-market rents.</p>	\$8,300,000																														
2005-120 (April 2006)	<p>California Student Aid Commission: Changes in the Federal Family Education Loan Program, Questionable Decisions, and Inadequate Oversight Raise Doubts About the Financial Stability of the Student Loan Program</p> <p><u>Cost Savings/Avoidance</u>—We recommended that the Student Aid Commission amend its operating agreement to require EDFUND to establish a travel policy that is consistent with the State's policy and that it closely monitor EDFUND expenses paid out of the Operating Fund for conferences, workshops, all-staff events, travel, and the like. By implementing policy changes as recommended, we estimate EDFUND could save a minimum of \$44,754 annually</p>	\$45,000																														
	Annualized carry forward from prior fiscal years:	<u>\$155,335,000</u>																														
	<table border="0"> <tr> <td data-bbox="451 1440 553 1461">2001-102</td> <td data-bbox="613 1440 992 1482">Department of Insurance Conservation and Liquidation Office</td> <td data-bbox="1101 1461 1187 1482">300,000</td> </tr> <tr> <td data-bbox="451 1503 553 1524">2001-107</td> <td data-bbox="613 1503 748 1524">Port of Oakland</td> <td data-bbox="1089 1503 1187 1524">7,500,000</td> </tr> <tr> <td data-bbox="451 1545 553 1566">2001-108</td> <td data-bbox="613 1545 938 1566">California Department of Corrections</td> <td data-bbox="1105 1545 1187 1566">733,000</td> </tr> <tr> <td data-bbox="451 1587 553 1608">2001-120</td> <td data-bbox="613 1587 781 1608">School Bus Safety II</td> <td data-bbox="1073 1587 1187 1608">44,300,000</td> </tr> <tr> <td data-bbox="451 1629 553 1650">2001-128</td> <td data-bbox="613 1629 878 1650">Enterprise Licensing Agreement</td> <td data-bbox="1089 1629 1187 1650">8,120,000</td> </tr> <tr> <td data-bbox="451 1671 553 1692">2002-101</td> <td data-bbox="613 1671 938 1692">California Department of Corrections</td> <td data-bbox="1073 1671 1187 1692">14,500,000</td> </tr> <tr> <td data-bbox="451 1713 553 1734">2002-009</td> <td data-bbox="613 1713 829 1734">California Energy Markets</td> <td data-bbox="1073 1713 1187 1734">29,000,000</td> </tr> <tr> <td data-bbox="451 1755 553 1776">2002-118</td> <td data-bbox="613 1755 878 1776">Department of Health Services</td> <td data-bbox="1073 1755 1187 1776">20,000,000</td> </tr> <tr> <td data-bbox="451 1797 553 1818">2003-125</td> <td data-bbox="613 1797 938 1818">California Department of Corrections</td> <td data-bbox="1073 1797 1187 1818">20,700,000</td> </tr> <tr> <td data-bbox="451 1839 553 1860">2003-124</td> <td data-bbox="613 1839 878 1860">Department of Health Services</td> <td data-bbox="1089 1839 1187 1860">4,600,000</td> </tr> </table>	2001-102	Department of Insurance Conservation and Liquidation Office	300,000	2001-107	Port of Oakland	7,500,000	2001-108	California Department of Corrections	733,000	2001-120	School Bus Safety II	44,300,000	2001-128	Enterprise Licensing Agreement	8,120,000	2002-101	California Department of Corrections	14,500,000	2002-009	California Energy Markets	29,000,000	2002-118	Department of Health Services	20,000,000	2003-125	California Department of Corrections	20,700,000	2003-124	Department of Health Services	4,600,000	
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Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit
I2004-2	Department of Health Services	9,000
I2004-2	Military Department	64,000
2004-105	California Department of Corrections	290,000
2004-033	Pharmaceuticals	5,100,000*
I2005-1	California Department of Corrections	119,000
Totals for July 1, 2005, through June 30, 2006		\$176,696,000
July 1, 2004, through June 30, 2005		
2003-125 (July 2004)	<p>California Department of Corrections: <i>More Expensive Hospital Services and Greater Use of Hospital Facilities Have Driven the Rapid Rise in Contract Payments for Inpatient and Outpatient Care</i></p> <p><u>Cost Savings</u>—The potential for the Department of Corrections (Corrections) to achieve some level of annual savings appears significant if it could negotiate cost-based reimbursement terms, such as paying Medicare rates, in its contracts with hospitals. We estimated potential savings of at least \$20.7 million in Corrections’ fiscal year 2002–03 inmate hospital costs. Specifically, had Corrections been able to negotiate contracts without its typical stop-loss provisions that are based on a percent discount from the hospitals’ charges rather than costs, it might have achieved potential savings of up to \$9.3 million in inpatient hospital payments in fiscal year 2002–03 for the six hospitals we reviewed that had this provision. Additionally, had Corrections been able to pay hospitals the same rates as Medicare—which bases its rates on an estimate of hospital resources used and their associated costs—it might have achieved potential savings of \$4.6 million in emergency room and \$6.8 million in nonemergency room outpatient services at all hospitals in fiscal year 2002–03. Recognizing that Corrections will need some time to negotiate cost-based reimbursement contract terms, we estimate that it could begin to realize savings of \$20.7 million annually in fiscal year 2005–06.</p>	†
2003-124 (August 2004)	<p>Department of Health Services: <i>Some of Its Policies and Practices Result in Higher State Costs for the Medical Therapy Program</i></p> <p><u>Cost Savings</u>— Represents the savings the Department of Health Services (Health Services) would have achieved in fiscal year 2002–03 had it paid only the amount specifically authorized by law for the Medical Therapy Program. Of the total, \$3.6 million relates to the full funding of county positions responsible for coordinating with services provided by special education programs; \$774,000 relates to Health Services’ method for sharing Medi-Cal payments with counties; and \$254,000 relates to Health Services’ failure to identify all Medi-Cal payments made to certain counties.</p>	\$4,600,000
I2004-2 (Allegation I2002-0853) (September 2004)	<p>Department of Health Services: <i>Investigations of Improper Activities by State Employees</i></p> <p><u>Cost Savings</u>—We found that managers and employees at the Department of Health Services’ (Health Services) Medical Review Branch office in Southern California regularly used state vehicles for their personal use. We estimate Health Services could save an average of \$9,260 each year because its employees no longer use state vehicles for personal use.</p>	\$9,000
I2004-2 (Allegation I2002-1069) (September 2004)	<p>California Military Department: <i>Investigations of Improper Activities by State Employees</i></p> <p><u>Cost Savings</u>—We found that the California Military Department (Military) improperly granted employees an increase in pay they were not entitled to receive. Because Military has returned all the overpaid employees to their regular pay levels, it should be able to save approximately \$64,200 each year.</p>	\$64,000
2004-105 (October 2004)	<p>California Department of Corrections: <i>Although Addressing Deficiencies in Its Employee Disciplinary Practices, the Department Can Improve Its Efforts</i></p> <p><u>Cost Savings</u>—The Department of Corrections could save as much as \$290,000 annually by using staff other than peace officers to fill its employment relations officer positions.</p>	\$290,000

Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit
12005-1 (Allegation I2003-0834) (March 2005)	California Department of Corrections: Investigations of Improper Activities by State Employees <u>Cost Recovery</u> —In violation of state regulations and employee contract provisions, the Department of Corrections (Corrections) paid 25 nurses at four institutions nearly \$238,200 more than they were entitled to receive between July 1, 2001, and June 30, 2003. In addition to recovering past overpayments, Corrections can save \$119,000 annually by discontinuing this practice. Although Corrections now contends that the payments to 10 of the 25 nurses were appropriate, despite repeated requests, it has not provided us the evidence supporting its contention. Thus, we have not revised our original estimate.	\$357,000
2005-030 (April 2005)	State Bar of California: It Should Continue Strengthening Its Monitoring of Disciplinary Case Processing and Assess the Financial Benefits of Its New Collection Enforcement Authority <u>Cost Recovery</u> —As a result of our recommendation that it prioritize its cost recovery efforts to focus on attorneys who owe substantial amounts, the State Bar sent demand letters to the top 100 disciplined attorneys and has received \$24,411.50 as of April 2006.	\$24,000 [†]
2004-033 (May 2005)	Pharmaceuticals: State Departments That Purchase Prescription Drugs Can Further Refine Their Cost Savings Strategies <u>Cost Savings/Avoidance</u> —In a prior audit, we had noted that opportunities existed for the Department of General Services (General Services) to increase the amount of purchases made under contract with drug companies, and we recommended in this audit that General Services continue its efforts to obtain more drug prices on contract by working with its contractor to negotiate new and renegotiate existing contracts with certain manufacturers. General Services reports that it has implemented contracts that it estimates will save the State \$5.1 million annually.	\$5,100,000*
	<u>Cost Recovery</u> —As we recommended, the Department of Health Services identified and corrected all of the drug claims it paid using an incorrect pricing method. It expects to recoup the nearly \$2.5 million in net overpayments that resulted from its error.	\$2,469,000
	Annualized carry forward from prior fiscal years:	\$109,976,000
	2001-102 Department of Insurance Conservation and Liquidation Office 300,000	
	2001-107 Port of Oakland 7,500,000	
	2001-108 California Department of Corrections 733,000	
	2001-120 School Bus Safety II 44,300,000	
	2001-128 Enterprise Licensing Agreement 8,120,000	
	2002-107 Office of Criminal Justice Planning 23,000	
	2002-009 California Energy Markets 29,000,000	
	2002-118 Department of Health Services 20,000,000	
Totals for July 1, 2004, through June 30, 2005		\$122,889,000
July 1, 2003, through June 30, 2004		
2002-121 (July 2003)	California Environmental Protection Agency: Insufficient Data Exists on the Number of Abandoned, Idled, or Underused Contaminated Properties, and Liability Concerns and Funding Constraints Can Impede Their Cleanup and Redevelopment <u>Increased Revenue</u> —The California Environmental Protection Agency received \$1 million in revenues after it applied for a one-time federal grant.	\$1,000,000
2003-106 (October 2003)	State Mandates: The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process <u>Cost Savings</u> —If the local entities we audited file corrected claims for the errors we identified, the State will save \$4.8 million (\$4.1 million related to the Peace Officers Procedural Bill of Rights mandate and \$675,000 related to the Animal Adoption mandate). We also recommended that the State Controller's Office audit the Peace Officers Procedural Bill of Rights claims that have been filed. We believe that such audits could yield savings of up to \$159.6 million.	\$4,800,000

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Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit
2003-102 (December 2003)	Water Quality Control Boards: <i>Could Improve Their Administration of Water Quality Improvement Projects Funded by Enforcement Actions</i>	\$301,000
	<u>Increased Revenue</u> —We identified 92 violations that require fine issuance and collection of the fines and three fines that were issued but not collected. The State Water Resources Control Board could increase its revenue if it collected these fines.	
2003-117 (April 2004)	California Department of Corrections: <i>It Needs to Ensure That All Medical Service Contracts It Enters Are in the State's Best Interest and All Medical Claims It Pays Are Valid</i>	\$96,000
	<u>Cost Savings/Avoidance</u> —Recovery of overpayments to providers for medical service charges in the amount of \$77,200 and the establishment of procedures to avoid lost discounts and prompt payment penalties totaling \$18,600.	
2003-138 (June 2004)	Department of Insurance: <i>It Needs to Make Improvements in Handling Annual Assessments and Managing Market Conduct Examinations</i>	\$7,000,000
	<u>Increased Revenue</u> —We estimate a one-time increase of revenue totaling \$7 million from the Department of Insurance's ability to make regulation changes that will result in capturing more specific data from insurers about the number of vehicles they insure. Future increases in revenue are undeterminable.	
	Annualized carry forward from prior fiscal years:	<u>\$110,033,000</u>
	2001-102 Department of Insurance Conservation and Liquidation Office 300,000	
	2001-107 Port of Oakland 7,500,000	
	2001-108 California Department of Corrections 733,000	
	2001-120 School Bus Safety II 44,300,000	
	2001-128 Enterprise Licensing Agreement 8,120,000	
	2002-107 Office of Criminal Justice Planning 23,000	
	2002-009 California Energy Markets 29,000,000	
	2002-118 Department of Health Services 20,057,000	
Totals for July 1, 2003, through June 30, 2004		\$123,230,000
July 1, 2002, through June 30, 2003		
2001-123 (July 2002)	Deaf and Disabled Telecommunications Program: <i>Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services</i>	\$268,000
	<u>Cost Savings</u> —Represents \$200,000 in known unremitted collections from intrastate telecommunication charges and \$68,000 in penalties and interest due for 2000 and 2001.	
2002-101 (July 2002)	California Department of Corrections: <i>A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management's Control</i>	†
	<u>Cost Savings</u> —We estimate that the Department of Corrections (Corrections) could save \$58 million if it reduces overtime costs by filling unmet correctional officer needs. This estimate includes the \$42 million we identified in our November 2001 report (2001-108). Corrections stated in its six-month response to this audit that, following our recommendation to increase the number of correctional officer applicants, it has submitted a proposal to restructure its academy to allow two additional classes each year. This action could potentially allow Corrections to graduate several hundred more correctional officers each year, thereby potentially contributing to a reduction in its overtime costs. However, any savings from this action would be realized in future periods. We estimate that Corrections could realize savings of \$14.5 million beginning in fiscal year 2005–06, with savings increasing each year until reaching \$58 million in fiscal year 2008–09.	

Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit															
2002-107 (October 2002)	<p>Office of Criminal Justice Planning: <i>Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery</i></p> <p><u>Cost Savings</u>—Represents estimated annual savings from the elimination of duplicative work conducted by the State Controller's Office. This savings would recur indefinitely.</p>	\$23,000															
2002-109 (December 2002)	<p>Department of Health Services: <i>It Needs to Better Control the Pricing of Durable Medical Equipment and Medical Supplies and More Carefully Consider Its Plans to Reduce Expenditures on These Items</i></p> <p><u>Cost Savings</u>—Represents savings the Department of Health Services (Health Services) would have achieved in fiscal year 2002–03 had it updated its maximum price for blood glucose test strips and volume remained the same as it was in the previous fiscal year. Also, beginning in fiscal year 2003–04, Health Services could save an additional \$2.7 million annually if it purchases stationary volume ventilators instead of renting them. However, because this action has not taken place, we are not adding the \$2.7 million to the monetary benefits estimate.</p>	\$911,000															
2002-009 (April 2003)	<p>California Energy Markets: <i>The State's Position Has Improved, Due to Efforts by the Department of Water Resources and Other Factors, but Cost Issues and Legal Challenges Continue</i></p> <p><u>Cost Savings</u>—In response to an audit recommendation, the Department of Water Resources (Water Resources) renegotiated certain energy contracts. Water Resources' consultant estimates that the present value of the potential cost savings due to contract renegotiation efforts as of December 31, 2002, by Water Resources and power suppliers, when considering replacement power costs, to be \$580 million. For the purpose of this analysis, we have computed the average annual cost savings by dividing the \$580 million over the 20-year period the savings will be realized. The estimated savings totaling \$580 million over 20 years varies by year from approximately -\$130 million to +\$180 million.</p>	\$29,000,000															
2002-118 (April 2003)	<p>Department of Health Services: <i>Its Efforts to Further Reduce Prescription Drug Costs Have Been Hindered by Its Inability to Hire More Pharmacists and Its Lack of Aggressiveness in Pursuing Available Cost-Saving Measures</i></p> <p><u>Cost Savings</u>— For two drugs we found that the net costs of the brand names were higher than those of the generics because the Department of Health Services (Health Services) failed either to renegotiate the contract or to secure critical contract terms from the manufacturer—errors we estimated cost Medi-Cal roughly \$57,000 in 2002. Additionally, Health Services estimated that it could save \$20 million annually by placing the responsibility on the pharmacists to recover \$1 copayments they collect from each Medi-Cal beneficiary filling a prescription. We estimate the State could begin to receive these savings each year beginning in fiscal year 2003–04.</p>	†															
	Annualized carry forward from prior fiscal years:	<u>\$61,103,000</u>															
	<table border="0"> <tr> <td data-bbox="467 1331 558 1352">2001-102</td> <td data-bbox="613 1331 997 1373">Department of Insurance Conservation and Liquidation Office</td> <td data-bbox="1105 1352 1182 1373">300,000</td> </tr> <tr> <td data-bbox="467 1394 558 1415">2001-107</td> <td data-bbox="613 1394 753 1415">Port of Oakland</td> <td data-bbox="1089 1394 1182 1415">7,500,000</td> </tr> <tr> <td data-bbox="467 1436 558 1457">2001-108</td> <td data-bbox="613 1436 943 1457">California Department of Corrections</td> <td data-bbox="1105 1436 1182 1457">883,000</td> </tr> <tr> <td data-bbox="467 1478 558 1499">2001-120</td> <td data-bbox="613 1478 786 1499">School Bus Safety II</td> <td data-bbox="1073 1478 1182 1499">44,300,000</td> </tr> <tr> <td data-bbox="467 1520 558 1541">2001-128</td> <td data-bbox="613 1520 894 1541">Enterprise Licensing Agreement</td> <td data-bbox="1089 1520 1182 1541">8,120,000</td> </tr> </table>	2001-102	Department of Insurance Conservation and Liquidation Office	300,000	2001-107	Port of Oakland	7,500,000	2001-108	California Department of Corrections	883,000	2001-120	School Bus Safety II	44,300,000	2001-128	Enterprise Licensing Agreement	8,120,000	
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2001-120	School Bus Safety II	44,300,000															
2001-128	Enterprise Licensing Agreement	8,120,000															
Totals for July 1, 2002, through June 30, 2003		\$91,305,000															
July 1, 2001, through June 30, 2002																	
2001-102 (July 2001)	<p>Department of Insurance Conservation and Liquidation Office: <i>Stronger Oversight Is Needed to Properly Safeguard Insurance Companies' Assets</i></p> <p><u>Cost Savings and Cost Recovery</u>—Recovery of overpayment to a contractor for \$43,000 and recovery of reinsurance not yet billed at \$1,385,000. In addition, cost savings of \$300,000 under the Conservation and Liquidation Office's (CLO) new contract with its investment managers, which will recur for many years. The CLO reported that it recovered the overpayment as of December 21, 2001.</p>	\$1,728,000															

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2001-107 (October 2001)	Port of Oakland: <i>Despite Its Overall Financial Success, Recent Events May Hamper Expansion Plans That Would Likely Benefit the Port and the Public</i> <u>Increased Revenue</u> —If the real estate division were to renegotiate its below-market leases to approximately 25 percent of their aggregate estimated fair market value, it could increase annual revenues. In 2002 three of the Port of Oakland’s (Port) below-market leases expired. If the Port renegotiated these leases to 25 percent of market value, the Port would realize over \$7.5 million annually.	\$7,500,000
2001-108 (November 2001)	California Department of Corrections: <i>Its Fiscal Practices and Internal Controls Are Inadequate to Ensure Fiscal Responsibility</i> <u>Cost Savings and Cost Recovery</u> —Recover \$24,000 of overpayment on overhead, save \$150,000 of future overhead costs through fiscal year 2002–03, save \$733,000 by eliminating unneeded contractor, which will recur for many years, and save \$42 million spent on overtime by filing vacant positions, which will recur for many years. We estimate that savings for fiscal year 2002–03 could be \$883,000 (\$150,000 plus \$733,000) and savings of \$733,000 annually for periods thereafter. However, since it may take the Department of Corrections (Corrections) a few years to fill its vacant positions, it is reasonable to expect Corrections to incrementally realize overtime cost savings over a five-year period starting in fiscal year 2005–06.	\$907,000
2001-120 (March 2002)	School Bus Safety II: <i>State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected</i> <u>Cost Savings</u> —We recommended that the Legislature clarify what activities are reimbursable. In 2002 the Legislature passed Assembly Bill 2781, which specifies that costs associated with implementation of transportation plans are not reimbursable claims. Costs for a six-year period ending June 30, 2002, were \$235.8 million and the ongoing costs after June 30, 2002, are \$44.3 million each year thereafter.	\$235,800,000
2001-128 (April 2002)	Enterprise Licensing Agreement: <i>The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars</i> <u>Cost Savings</u> —The State and Oracle agreed to rescind the contract in July 2002. As a result, we estimate the State will save \$8,120,000 per year for five years starting in fiscal year 2002–03.	†
2001-116 (April 2002)	San Diego Unified Port District: <i>It Should Change Certain Practices to Better Protect the Public’s Interests in Port-Managed Resources</i> <u>Increased Revenue</u> —We estimate an increase in revenue of \$700,000 per year by obtaining market value rents. This monetary benefit will recur for many years, however, it is not anticipated to begin until 2007.	†
2001-124 (June 2002)	Los Angeles Unified School District: <i>Outdated, Scarce Textbooks at Some Schools Appear to Have a Lesser Effect on Academic Performance Than Other Factors, but the District Should Improve Its Management of Textbook Purchasing and Inventory</i> <u>Cost Savings</u> —We found that some publishers are not equitably providing free instructional materials (commonly referred to as gratis items) to different schools within Los Angeles Unified School District (LAUSD), as state law requires. Subsequently, LAUSD reports that it negotiated with publishers and thus far one publisher has actually provided approximately \$300,000 in gratis items.	\$1,762,000

Totals for July 1, 2001, through June 30, 2002	\$247,697,000
Totals for July 1, 2001, through December 31, 2006	\$953,577,000

* This monetary benefit was not previously reported because the Department of General Services had not yet implemented the contracts resulting in this savings.

† Although we identified monetary benefits the auditee could reasonably expect to realize if it implements our recommendations, these benefits would be realized in a future period rather than the period in which the report was issued. Therefore, the appropriate amounts either are or will be included in future years’ annualized carry forward.

‡ This monetary benefit was previously listed as \$2,700. The State Bar reported that it has since received an increased amount of cost recovery.

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