Implementation of State Auditor's Recommendations

Audits Released in January 2006 Through December 2007

Special Report to
Assembly and Senate
Standing/Policy Committees

February 2008 Report 2008-406

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February 21, 2008 2008-406

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 summarizes monetary benefits auditees could realize if they implement our recommendations or take appropriate corrective action.

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

ELAINE M. HOWLE
State Auditor

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Revenue and Taxation

Introduction

This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2006 through December 2007. 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 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 report summaries that relate to an area's jurisdiction. Because an audit or investigation may involve more than one issue or because it may cross the jurisdictions of more than one standing committee, a report summary could be included in more than one policy area. For example, for an audit of the Batterer Intervention Program, the audit report summary would be listed under three policy areas—Judiciary, Local Government, and Privacy and Public Safety.

We have compiled the recommendations we directed to the Legislature and have summarized them in a separate report we issued in January 2008. Additionally, we have summarized monetary benefits such as cost recoveries, cost savings, or increased revenues that we estimated auditees could realize if they implement our recommendations or take appropriate corrective action in the Appendix. We estimate that auditees could have realized more than $1.16 billion of monetary benefits during the period July 1, 2001, through December 31, 2007, if they implemented our recommendations. For example, in our audit of the Department of Health Services' (Health Services) progress in implementing the Skilled Nursing Quality Assurance Fee and Medi-Cal Long-Term Care Reimbursement Act, we evaluated Health Services' new facility-specific reimbursement rate system, which is used to reimburse facilities for providing Medi-Cal services. Among other issues we reported, the Health Services' contractor responsible for authorizing payment of facility Medi-Cal claims authorized duplicate payments to some facilities. We detected more than 2,100 duplicate payments totaling more than $3.3 million after reviewing just 12 months worth of paid claims—duplicate payments the contractor was not aware it had authorized. Because the scope of the audit was focused on only one of many types of claims this contractor authorizes for payment, we recommended that Health Services further investigate for any other duplicate payments, correct the flaw that caused the improper authorizations, and recoup all the duplicate payments detected. Health Services did indeed investigate and, at the time of its response, found an additional $2.8 million in duplicate payments that it plans to recover, for a total of $6.1 million. During our audit of the State's compliance with federal regulations, we will review what Health Services has thus far investigated and will determine the magnitude of any additional overpayments.

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, state law requires 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 2008.

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.

Department of Health Services

It Has Not Yet Fully Implemented Legislation Intended to Improve the Quality of Care in Skilled Nursing Facilities

REPORT NUMBER 2006-035, FEBRUARY 2007

Department of Health Services' response as of August 2007

The Skilled Nursing Facility Quality Assurance Fee and Medi-Cal Long-Term Care Reimbursement Act (Reimbursement Act), Chapter 875, Statutes of 2004, directed the Bureau of State Audits to review the Department of Health Services' (Health Services)[1] new facility-specific reimbursement rate system. Until the passage of the Reimbursement Act, facilities received reimbursements for Medi-Cal services based on a flat rate. The Reimbursement Act required Health Services to implement a modified reimbursement rate methodology that reimburses each facility based on its costs. In passing the Reimbursement Act, the Legislature intended the cost-based reimbursement rate to expand individual's access to long-term care, improve the quality of care, and promote decent wages for facility workers. The Reimbursement Act also imposed a Quality Assurance Fee (fee) on each facility to provide a revenue stream that would enhance federal financial participation in the Medi-Cal program, increase reimbursements to facilities, and support quality improvement efforts in facilities.

The Reimbursement Act required us to evaluate the progress Health Services has made in implementing the new system for facilities. It also directs us to determine if the new system appropriately reimburses facilities within specified cost categories and to identify the fiscal impact of the new system on the State's General Fund.

Audit Highlights . . .

Our review of the Department of Health Services' (Health Services) progress in implementing the Skilled Nursing Quality Assurance Fee and Medi-Cal Long-Term Care Reimbursement Act (Reimbursement Act) revealed:

- ***Although Health Services promptly obtained federal approval for the reimbursement rate and fee systems, it was delayed in installing the new rates for Medi-Cal payments.***
- ***Health Services has not yet met all of the auditing requirements included in the Reimbursement Act, but has recently hired 20 additional auditors to meet the requirement.***
- ***Health Services has not reconciled the fee payments made by facilities to its record of anticipated collections.***
- ***Health Services believes the Reimbursement Act will result in General Fund savings. However, the savings projections do not consider $5.2 million in ongoing costs prompted by the act.***
- ***Health Services did not follow sound contracting practices when it contracted with its consultant to develop a system to calculate rates.***
- ***Health Services was not able to provide the methodology underlying the reimbursement rate system. As a result, we could not verify that the system appropriately calculates rates. To make such a verification in a separate public letter, we asked Health Services to provide a complete and accurate methodology of the system within 60 days of this report's publication.***

continued on next page . . .

Finding #1: Health Services has not yet met all the auditing requirements included in the Reimbursement Act, having reviewed only about two-thirds of the State's facilities.

When a facility reports costs, Health Services has an obligation to perform an audit to ensure that those costs are reasonable. If an audit reveals a discrepancy, Health Services must make an audit adjustment, which becomes the amount Health Services uses to develop the facility's reimbursement rate. In fact, Health Services calculated approximately one-third of all facilities' reimbursement rates using unaudited cost data.

We recommended that Health Services conduct all the audits of facilities called for in the Reimbursement Act to reduce the risk of using flawed data to calculate reimbursement rates.

[1] Effective July 1, 2007, the Department of Health Services was renamed as the Department of Health Care Services as a result of Senate Bill 162.

» *Neither Health Services nor its consultants formally made changes to final reimbursement rates or to the reimbursement rate system.*

» *Health Services' contractor responsible for receiving and authorizing payment for Medi-Cal claims, authorized over $3.3 million in duplicate payments to some facilities for the same services.*

» *Health Services and its contractor have begun the process of recouping the duplicate payments.*

Health Services' Action: Partial corrective action taken.

Health Services reported that it plans to use the additional 19 auditor positions and two audit manager positions approved in the 2006–07 budget to conduct audits of all free-standing skilled nursing facilities (facility) as required in the Reimbursement Act. It plans to complete all of the required audits during the 2007–08 production year.

➲ Health Services does not plan to identify which audits it conducted in 2004 stating that the Reimbursement Act was not enacted until 2005. In addition, it believes the number of audits completed in 2005 met the requirements of the Reimbursement Act. However, as stated in the report, before passage of the Reimbursement Act, Health Services conducted a field audit for each facility once every three years. To meet the requirement for the Reimbursement Act, Health Services must continue to complete a field audit once every three years and also complete a desk audit in the years in between. Since Health Services did not distinguish between field and desk audits in its records, it cannot be sure it has met the field audit requirement. We recommend that Health Services look back to the audits completed in fiscal years 2004–05 through 2006–07 to identify which facilities received a field audit within those three years and adjust its audit plan accordingly.

Finding #2: Health Services has not reconciled its fee receipts to its records of anticipated collections.

In addition to new facility rates, the Reimbursement Act established the quality assurance fee to provide a new revenue stream for Health Services. Before it started collecting fee payments, Health Services estimated each facility's annual reported resident days and recorded the estimate in a database. Since the fee amount each facility pays is based on resident days, each facility reports actual resident days for the period and the total fee due when it remits the fee payment. On receiving this information, Health Services records it in the database next to its estimates. However, Health Services had not reviewed these records and as a result it may not have collected all the 2004 fees due. By reviewing its records of fee payments received alongside its estimates, Health Services could have promptly identified delinquent facilities and facilities that have incorrectly reported resident days by investigating reported resident days that vary by more than 5 percent from its estimate.

We recommended that Health Services reconcile the fee payments made by facilities to the estimated payments due and follow up on significant variances. For those facilities that have not paid the full fee, we recommended that Health Services promptly initiate collection efforts.

Health Services' Action: Partial corrective action taken.

Health Services reported that it has begun notifying facilities of outstanding fee balances and is receiving regular responses from those facilities. In addition, it reports that it has completed reconciling its fee payment records and has a process in place for collecting aged fee receivables.

Finding #3: Although the Reimbursement Act allows contracting, we are concerned about Health Services' contracting practices and its continued reliance on contracted services to maintain and update the new reimbursement rate system.

Health Services did not always follow sound contracting practices. The consultant it hired to provide advice and research related to reimbursement rate methodologies was responsible for developing the reimbursement rate system, even though development work was not included in the scope of the contract. Health Services should have included detailed expectations in the contract for the final product. Additionally, it should have required the consultant to document the process used to build the system. Because it failed to include these details in the contract, Health Services does not have a blueprint of the system, leaving it vulnerable in the event of a system failure and at greater risk should the system fall short of Health Services' needs. In fact, when we attempted to replicate the reimbursement rate system that produced the 2005–06 rates, neither Health Services nor its consultant were able to provide a complete methodology used to develop the system. As a result, we have asked Health Services to develop and test formal, accurate and detailed documentation that includes all of the complexities of the rate development methodology within 60 days of this report's publication.

Additionally, Health Services anticipated taking over rate development but did not specify in its contract with its consultant a date for doing so.

We recommended that Health Services amend the contract to clearly describe the scope of work, include a statement that Health Services will obtain the logic and business rules of the reimbursement rate system, and a specific date that Health Services will take over the reimbursement rate calculation. In addition, we requested formal and detailed documentation that includes all of the complexities of the reimbursement rate development with its 60-day response.

Health Services' Action: Partial corrective action taken.

According to Health Services, it prepared a contract amendment that included a turnover plan. This turnover plan required the consultant to provide the logic and business rules of the reimbursement rate system and train Health Services' employees to operate the system. Health Services reported that the amended contract was approved in May 2007. Health Services further stated that its staff has received the training necessary to operate the reimbursement rate system and is working with the consultant to calculate and implement rates for the upcoming year.

Additionally, Health Services provided formal detailed documentation that included all of the complexities of the reimbursement rate development methodology used to produce the reimbursement rates Health Services published for fiscal year 2005–06 in its 60-day response.

Finding #4: Health Services does not have a mechanism in place to record changes made to published rates or the reimbursement rate system.

Health Services does not formally document and record changes to its published rates or changes to its reimbursement rate system. As a result of not keeping formal records, it could not provide an overall record of changes it made to its published rates or the basis for changing those rates. Health Services develops rates for facilities and forwards them to the Electronic Data Systems (EDS), Health Services' consultant. EDS is responsible for entering these rates into its system and applying them to Medi-Cal claims. However, EDS authorized payment for some Medi-Cal claims in fiscal year 2005–06 using rates that were different than those Health Services had published. When asked about changes to the published rates, Health Services stated that most of the changes were probably initiated by the facilities after the rates were finalized. However, since Health Services is responsible for developing rates, it is also responsible for formally tracking changes made to those rates.

In addition, neither Health Services nor the consultant that developed the reimbursement rate system have a formal change control process in place to record programming changes the consultant makes or may need to make to the system.

We recommended that Health Services formalize a rate change process that documents the reason for rate changes and any changes either it or its contractor responsible for administering the system makes to the reimbursement system's programming language.

Health Services' Action: Corrective action taken.

Health Services reported that it has implemented a system that provides an audit trail for any facility rate change. It further stated that it has developed and implemented procedure changes in the system's programming language.

Finding #5: Health Services is to report information that reflects changes in quality of care to the Legislature. Although the law does not require it, we believe including General Fund cost information in those reports would show how the new rates are affecting the General Fund.

Because the Reimbursement Act sunsets on July 1, 2008, the Legislature will be reviewing its overall impact on the quality of care in facilities and its fiscal impact on the State. The Reimbursement Act mandates that Health Services issue reports to the Legislature in January 2007 and January 2008. Both reports are to focus on elements outlined in the Reimbursement Act to give the Legislature an idea of what improvements the increased rates produced. The Reimbursement Act, in its outline of the information that Health Services should include in the reports, did not specify the inclusion of any information related to the effect higher reimbursement rates and the new fee revenue have on overall General Fund expenditures. In addition, although the Reimbursement Act requested that our audit provide information regarding the impact of the new reimbursement rates on the General Fund, we can provide only actual General Fund cost information for fiscal year 2005–06. By including General Fund cost information in both of the required reports from Health Services, the Legislature would have more information to assess the act's true costs and benefits.

We recommended that Health Services include information on any savings to the General Fund in the reports its licensing division is required to prepare.

Health Services' Action: None.

➲ Health Services' Licensing and Certification Division (division) agrees that both cost and benefit information may be useful to the Legislature. However, because General Fund cost information is collected and maintained by either operational areas of the department, the division stated it would have to be prepared by another operational area. Health Services did not state whether it included or intends to include General Fund cost information in its reports to the Legislature.

Finding #6: Health Services ' contractor responsible for receiving and authorizing payment of facility Medi-Cal claims, authorized paying some facilities more than once.

Although this contractor was unaware that it was authorizing duplicate payments, we found more than 2,100 instances of such payments totaling over $3.3 million since October 2005. Because the scope of the audit included only long-term care Medi-Cal payments for the 2005–06 fiscal year, we were unable to reach a conclusion as to whether the duplicate payments extended beyond the population examined.

We recommended that Health Services further investigate the possibility that duplicate payments were authorized by the contract consultant to ensure that the magnitude of the problem is identified and controlled. In addition, we recommended that Health Services begin recouping those duplicate payments.

Health Services' Action: Partial corrective action taken.

After learning that its contractor, EDS, issued duplicate payments, Health Services reported that it took immediate corrective action by implementing a special processing guideline that discontinued the procedure to override suspended claims. It also conducted an investigation to determine the magnitude of the flawed procedure. In its six-month response, Health Services stated that it has also completed its investigation of Medical, Outpatient, and Vision claims and found a similar processing error that resulted in additional erroneous duplicate payments of certain claims. It further reported that it immediately issued a special processing guideline to temporarily correct the processing error while it develops the edit criteria that will permanently correct the error.

Health Services stated that it expects to recover the duplicate payments by issuing two Erroneous Payment Corrections (EPC). Health Services stated that the first EPC will recover approximately $5.3 million in duplicate Long Term Care payments and an additional $780,000 for duplicate or overlapping payments made to one or more different provider entities. The second EPC will recover funds for the Medical, Outpatient and Vision claims by October 2007. However, Health Services stated that it does not yet know the total dollar overpayment for that EPC.

Department of Health Services

Its Licensing and Certification Division Is Struggling to Meet State and Federal Oversight Requirements for Skilled Nursing Facilities

REPORT NUMBER 2006-106, APRIL 2007

Department of Health Services' response as of October 2007

The Joint Legislative Audit Committee requested the Bureau of State Audits to conduct an audit assessing the Department of Health Services' (Health Services)[1] oversight of skilled nursing facilities. Specifically, we found the following:

Audit Highlights . . .

Our review of the Department of Health Services' (Health Services) oversight of skilled nursing facilities revealed the following:

- ***Health Services has struggled to initiate and close complaint investigations and communicate with complainants in a timely manner.***
- ***Health Services did not correctly prioritize certain complaints and understated the severity of certain deficient practices it identified at skilled nursing facilities.***
- ***Health Services has yet to implement an Internet-based inquiry system as required by state law to provide consumers with accessible public information regarding skilled nursing facilities.***
- ***The system Health Services uses to track complaint investigations regarding skilled nursing facilities has weak controls over data integrity that could allow erroneous data to be entered into the system without being detected.***
- ***The timing of some federal recertification surveys is more predictable than others, which diminishes the effectiveness of these reviews.***
- ***Health Services has weak controls over its disbursements of funds from the Health Facilities Citation Penalties Account, which limit its ability to ensure that funds are used for necessary purposes.***
- ***Despite efforts to increase staffing, Health Services has struggled to fill its vacant facility evaluator positions with registered nurses. This reliance on registered nurses is also problematic because of the current nursing shortage and higher salaries offered elsewhere.***

Finding #1: Health Services has been unable to initiate and close its complaint investigations promptly.

We found that Health Services has struggled to investigate and close complaints promptly. The Health and Safety Code requires Health Services to initiate investigations of all but the most serious complaints within 10 working days. Additionally, according to its policy, Health Services' goal is to complete a complaint investigation within 45 working days of receiving the complaint. To measure how promptly Health Services initiated and closed complaint investigations, we use data from its complaint-tracking system. We found that data related to the dates Health Services received complaints, initiated investigations, and closed complaints were of undetermined reliability. The data were of undetermined reliability primarily because of weaknesses in application controls over data integrity. According to these data, Health Services received roughly 17,000 complaints and reports of incidents that facilities self-reported between July 1, 2004, and April 14, 2006. Although not every complaint Health Services receives and reviews warrants an investigation, we found that Health Services promptly initiated investigations for only 51 percent of the 15,275 complaints for which it began investigations and promptly completed investigations only 39 percent of the time. To proactively manage its complaint workload, we recommended that Health Services periodically evaluate the timeliness with which district offices initiate and complete complaint investigations. Based on this information, Health Services should identify strategies, such as temporarily lending its staff to address workload imbalances occurring amongst district offices.

Health Services' Action: Partial corrective action taken.

In its 60-day response, Health Services indicated that it continued to facilitate the deployment of staff from one district office to another for the purpose of addressing survey deadlines and the investigation of complaints. As of October 2007 Health Services

[1] On July 1, 2007, the California Department of Health Services was reorganized and became two departments—the Department of Health Care Services and the Department of Public Health. The Department of Public Health is now responsible for monitoring skilled nursing facilities.

reports that only 19 of the 1,925 complaints it has received since April 17, 2007, were initiated beyond the 10 working-day requirement. However, Health Services provided no comparable information related to its efforts to close complaints promptly.

Finding #2: Health Services did not always communicate with complainants within required time frames.

Health Services' staff could not demonstrate that they have consistently communicated with complainants promptly. Program statutes require Health Services to acknowledge its receipt of complaints within two working days and inform complainants in writing of the results of their investigations within 10 working days of completing their work. For 21 of the 35 complaints we reviewed, the files contained copies of the initial letters to the complainants. In seven of these 21 cases, we found that Health Services notified the complainant beyond the two working-day time frame. For the most delayed case, it took Health Services 104 days to notify the complainant. Similarly, for all 22 cases that contained copies of the second letter, we found that Health Services notified the complainant of the results of the investigation beyond the 10 working-day time frame. In the most delayed case, it took Health Services 273 days to provide this notification to the complainant. The main cause for delays in providing the second notice appears to be Health Services' practice of waiting for the facility to first submit its plan of correction, which can take another 10 to 15 days beyond the date the facility was notified, before informing the complainant of the investigation results. By failing to consistently meet deadlines for communicating with complainants, Health Services unnecessarily exposes complainants to continued uncertainty about the well being of residents at skilled nursing facilities.

To ensure that it fully complies with state law regarding communication with complainants, we recommended that Health Services reassess its current practice of delaying notification to complainants about investigation results until after it receives acceptable plans of correction from cited skilled nursing facilities. If Health Services continues to support this practice, it should seek authorization from the Legislature to adjust the timing of communications with complainants accordingly.

Health Services' Action: Corrective action taken.

Health Services has inserted additional guidance in its complaint investigation procedures to address our recommendation. Specifically, Health Services now requires its staff to notify complainants of the results of investigations within 10 days following the last day of the on-site inspection. Further, Health Services' quality assurance process includes auditing complaint files to see if the letter was sent in a timely manner and included in the hard copy file.

Finding #3: Health Services has not consistently investigated complaints and included all relevant documentation within complaint files.

Our review noted that, although there is a policy to close complaints within 45 working days of receiving them, Health Services' complaint investigation procedures do not establish guidelines for the timely completion of the various stages of the complaint investigation process. Without timelines for individual steps in the complaint investigation process linked to the parties responsible for performing them, Health Services cannot be sure its objectives are being met and will have difficulty holding staff accountable for the timely completion of work. Further, we found that Health Services' complaint files did not always contain sufficient documentation to help explain where delays in the process were occurring, and to evidence the completion of required activities.

To evaluate Health Services' practices for investigating complaints, we reviewed five complaint investigation files at each of the seven district offices we visited. We found that for 18 of the 35 complaints, just the time it took between starting an on-site investigation and notifying the facility in writing of the results equaled or exceeded the 45 working-day policy for closing complaints. In 15 of these 18 instances we were able to identify the cause of these delays, such as facility evaluators needing more time to complete their work prompted by obtaining additional information or interviewing other individuals not located at skilled nursing facilities. However, in three cases we could not make this determination either because of missing investigation reports or reports that were completed after Health Services notified the facility about the results. We saw similar documentation problems regarding Health Services' efforts to provide timely notifications to complainants. Specifically, Health Services could not provide evidence that it acknowledged receipt of a complaint for four of the 35 complaints we reviewed, while similarly being unable to produce evidence that it informed complainants of the results of investigations in seven instances.

To ensure that district offices consistently investigate complaints and include all relevant documentation in the complaint files, Health Services should clarify its policies and procedures, provide training as necessary, and periodically monitor district office performance to ensure compliance. At a minimum, Health Services should:

- Clarify its 45 working-day policy for closing complaints by establishing target time frames for facility evaluators, supervisors, and support staff to complete key stages in the complaint process.
- Ensure that each complaint file includes a workload report (timesheet), an investigation report, and copies of both letters sent to complainants.
- Clarify that investigation reports should be signed and approved prior to notifying skilled nursing facilities about the results of investigations.
- Attempt to obtain mailing addresses from all complainants that do not wish to remain anonymous.

Health Services' Action: None.

Although Health Services' initial response to the audit indicated that it would revise its policy and procedures manual to include "clearly established timeframes and expectations for work products to be completed, reviewed, and processed," its more recent 60-day and six-month responses were less committal on this issue. Specifically, Health Services' 60-day response simply indicated that it would "consider development of target timeframes for staff to complete key stages of the complaint process." Its six-month response indicated that the recommendation had been met; however, Health Services' response was silent on whether these target time frames had been established in its revised policies and procedures. Our review of Health Services' revised policies and procedures manual indicated that it has not developed these time frames. As noted above, without these timelines for individual steps in the complaint investigation process, Health Services' cannot insure that its objectives are being met and will have difficulty holding staff accountable for the completion of their work. Although Health Services' new quality assurance process reviews various aspects of the complaint investigation process, including whether complaints were correctly prioritized and investigated, it does not review how long it takes to complete complaint investigations and the cause for any delays beyond its stated policy of 40 days.

Finding #4: Health Services may have understated the priority levels of complaints received and the severity levels of deficiencies identified during recertification surveys.

We found that Health Services may not have correctly prioritized complaints it received against skilled nursing facilities. For 12 of the 35 complaints we reviewed, Health Services may have understated the priority of complaints that, according to requirements, would have warranted more urgent investigations. We also found that Health Services may have understated the severity of the deficiencies it identified for nine of the 35 recertification surveys we reviewed. When Health Services does not classify deficiencies at a sufficiently severe level, the enforcement actions Health Services imposes on skilled nursing facilities may not be adequate, and facility stakeholders may form misperceptions about the quality of care offered at those facilities.

We recommended that Health Services ensure that staff correctly and consistently prioritize complaints and categorize the deficient practices of skilled nursing facilities.

Health Services' Action: Corrective action taken.

Health Services' new quality assurance program includes reviewing randomly selected complaint investigations to ensure, among other things, that complaints are appropriately prioritized and that complaint dispositions are appropriate.

Finding #5: Health Services has failed to meet state requirements for providing public access to information on skilled nursing facilities.

To enhance the quality and public accessibility of information on long-term care facilities, the Legislature passed Assembly Bill 893 (Chapter 430, Statutes of 1999), which required Health Services to provide the public with an on-line inquiry system accessible through a toll-free telephone number and the Internet. This inquiry system must provide information to consumers regarding a skilled nursing facility of their choice, including its location and owner, number of units or beds, and information on state citations assessed. Our audit found that Health Services has been unable to fully implement this system nearly five years after the Legislature's deadline of July 1, 2002. Health Services' management asserted that budget shortfalls in fiscal years 2003–04 and 2004–05 have hampered its efforts to implement the Internet-based system.

We recommended that Health Services continue in its efforts to implement an Internet-based inquiry system and take steps to ensure that the data it plans to provide through the system are accurate.

Health Services' Action: Partial corrective action taken.

In September 2007 Health Services entered into a contract with a vendor for the design, development, and implementation of the "Health Facilities Consumer Information System." It expects this system will provide the public with access to long-term care facility information. Health Services expects to deploy the first phase of this system between February and March 2008, which will include information regarding long-term care facilities. The system will subsequently include information regarding hospitals. To address data reliability concerns, Health Services reports that 95 percent of all district office management and support staff have attended training regarding data processing and entry practices for its current systems.

Finding #6: The system Health Services uses to track complaint investigations is governed by weak application controls.

Health Services complaint-tracking system is one module in the Automated Survey Processing Environment (ASPEN), a database developed and maintained by the Centers for Medicare and Medicaid Services (CMS). Health Services' district offices enter complaint investigation and federal recertification survey data into ASPEN for all facilities within California. Our audit found that the complaint-tracking system has weak application controls that preclude Health Services from preventing erroneous data from being entered into the system or detecting data errors or omissions within the system. We also found that district office data entry staff are not consistently using the complaint-tracking system to record data regarding complaint investigations. For example, data entry staff record two different events in the field designed to capture the on-site investigation completion date. Some data entry staff record the date that the on-site investigation ended, while others record the date when the facility evaluators have determined the type of enforcement action to take. In addition, we found instances in which various dates in the complaint-tracking system conflicted with the normal sequence of events that occurs when Health Services investigates a complaint. For example, 677 of the 17,042 records in the system's population of complaints that were prioritized at either the immediate-jeopardy or non-immediate-jeopardy level and were received between July 1, 2004, and April 14, 2006, have entries indicating that some step in the investigation process occurred before the complaint was recorded as received.

To improve the accuracy of complaint data used to monitor its workload and staff performance, we recommended that Health Services develop strong application controls to ensure that its data are accurate, complete, and consistent. This process should include validating the data entered into key data fields, ensuring that key data fields are complete, and training staff to ensure consistent input into key data fields, such as the field designed to capture the date on which the investigation was completed.

Health Services' Action: Partial corrective action taken.

Health Services indicated that it has been working aggressively with CMS to enhance the ASPEN system. For example, Health Services reports that it met with the director of CMS' survey and certification division in April 2007 to discuss the results of our audit and to emphasize the need for "hard edits" in the ASPEN system. In addition, Health Services indicated that on May 22, 2007, program managers discussed the data accuracy problems identified by CMS during its annual "State Agency Evaluation of Performance Review." As part of its corrective action measures in response to this annual review, Health Services was required to develop written procedures for data entry and that staff would receive training on these procedures. Further, Health Services indicated that its managers would be responsible for pulling complaint and survey files throughout the year to check data entry accuracy with paper files. In its most recent response to the audit in October 2007, Health Services reported that in September 2007 it had reminded its managers to conduct these random reviews. Finally, Health Services reviews data accuracy in ASPEN through its new quality assurance program.

Finding #7: Health Services could enhance the value of its recertification surveys by making its visits less predictable.

Federal regulations prescribe the frequency with which Health Services must conduct its recertification surveys of skilled nursing facilities, requiring a survey no later than 15 months after a facility's prior survey, with an average of 12 months between all of its recertification surveys of skilled nursing facilities statewide. In interpreting these regulations, the CMS actually allows states more generous time frames of 15.9 months between recertification surveys and a statewide average survey interval of 12.9 months. As of June 2006 Health Services' survey interval averaged 12.2 months, and only one survey had occurred more than 15.9 months after the facility's last survey.

Although Health Services has been able to meet recertification survey frequency requirements statewide, it could improve the randomness with which it schedules the surveys. According to CMS, "states have a responsibility for keeping surveys unannounced and their timing unpredictable. This gives the state agency doing the surveying greater ability to obtain valid information." Our own analysis indicates that some district offices may have performed better than others in managing their workloads and varying the timing of their recertification surveys. For example, most recertification surveys conducted within the jurisdiction of the Daly City district office occurred near the end of the 15.9-month federal deadline, allowing little room for variability. In contrast, the Chico district office was less predictable in its scheduling of surveys because it did not concentrate its activity immediately before a known deadline.

To reduce the predictability of its federal recertification surveys, we recommended that Health Services institute a practice of conducting surveys throughout the entire survey cycle, ensuring that each facility has a greater probability of being selected at any given time.

Health Services' Action: Pending.

Health Services reports that it plans to use CMS' ASPEN system to help schedule recertification surveys in a way that will reduce their predictability. In preparation for using ASPEN in this way, Health Services indicated that it has provided training to its staff on the use of ASPEN's Scheduling and Tracking System (AST). Health Services expects to implement AST in January 2008.

Finding #8: Health Services has weak controls for disbursing certain funds from the Health Facilities Citation Penalties Account (citation account).

We generally found that Health Services' controls over the expenditure of funds from the citation account were weak. Allowable uses of citation account funds are prescribed within state law and include paying for the costs of ensuring the continued operation of a skilled nursing facility pending its correction of cited deficiencies or closure, including the appointment of temporary management or receivership, in the event that revenues form the facility are insufficient. Our review of citation account expenditures revealed that Health Services relied on high-level forecasts of expected revenues and expenses submitted in e-mails by temporary management companies as a basis to request funding. Given the magnitude of some of these payments—we noted one instance in which a single payment exceeded $700,000—we would have expected Health Services to eventually request evidence beyond the e-mails to gain some assurance that the payments made were necessary.

In addition, Health Services provided more than $10.5 million to one temporary management company and had only one other approved temporary management company available for use. With such a small pool of qualified and available temporary management companies, Health Services may have less ability to employ such firms as a means of effecting change in underperforming skilled nursing facilities and has less assurance that it is getting a competitive price for these services. Finally, our review found that Health Services did not maintain adequate support for $581,000 in citation account funds that it used to purchase computers for its licensing and certification division.

To ensure it can adequately justify the expenses it charges to the citation account, we recommended that Health Services take steps to gain assurance from temporary management companies that the funds they received were necessary. This should include reviewing the support behind temporary management companies' e-mails requesting payments. In addition, Health Services should take steps to expand its pool of temporary management companies to ensure that it has sufficient numbers of temporary management companies available and receives competitive prices. Finally, when Health Services charges general support items to the citation account, it should be able to document its rationale for determining the amounts charged.

Health Services' Action: Pending.

Health Services reports that it has drafted new policies and procedures regarding the appointment of temporary managers. These draft policies define the roles and responsibilities of Health Services' staff and the temporary management company, as well as include the reporting responsibilities and financial process including requesting payment for services. Health Services indicates that it is now developing a solicitation of applications aimed at increasing the pool of eligible temporary managers.

Finding #9: Staffing shortages hamper Health Services' enforcement efforts, and filling its vacant positions remains difficult.

Health Services cited staffing shortages as the cause of many of its oversight problems. We believe that Health Services' explanation has some merit. Our review of the staffing levels within the Field Operations Branch (branch) of the Licensing and Certification Division indicated that securing adequate staffing has been a problem. In the fiscal year 2005–06 budget, the Legislature approved funding for 485 positions within the branch, of which 397 were facility evaluator positions. During the same year, the branch reported it was able to fill 426 of these approved positions, of which 347 were facility evaluators. Most of these facility evaluators are registered nurses, accounting for 78 percent of the 397 health facility evaluator positions authorized in fiscal year 2005–06. Annual vacancy rates for these positions averaged about 16 percent between fiscal year 2002–03 and 2005–06 but have declined slightly each year since fiscal year 2003–04. Health Services primarily focuses on hiring candidates that are registered nurses; however, a nursing shortage and higher salaries elsewhere make filling these positions problematic.

To fill its authorized positions and manage its federal and state workloads, we recommended that Health Services consider working with the Department of Personnel Administration (DPA) to adjust the salaries of its staff to make them more competitive with those of other state agencies seeking similarly qualified candidates. In addition, Health Services may want to consider hiring qualified candidates who are not registered nurses. Finally, if these options prove unsuccessful, Health Services should develop additional strategies, such as temporarily reallocating its staff from district offices that are less burdened by their workloads to those facing the highest workloads.

Health Services' Action: Pending.

Health Services reports that it formed a workgroup to draft new classification specifications for its health facility evaluator employees. With the draft specifications complete, Health Services has come to an agreement with a vendor to validate the new classification specifications and develop the necessary documents for submission to the DPA. As of December 2007 Health Services reports that General Services is still reviewing the contract and that it has not been fully executed. Health Services plans to submit the classification package to DPA in June 2008. In addition, Health Services indicated that it has temporarily redirected staff on a voluntary basis to those district offices that are overburdened with workload due to difficulty in recruiting qualified staff.

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

REPORT NUMBER 2005-113, MARCH 2006

State Water Resources Control Board's response as of March 2007

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 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.

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.***
- ***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.***

continued on next page . . .

» ***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.***

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 February 2007, it has reviewed and corrected 2,737 of the 12,571 water right files and it intends to review another 1,899 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. The water board stated that it has posted an example invoice on its Web site. In addition, the water board stated that it intends to send a letter to all of the fee payers in its next billing 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 and again on September 5, 2006, and February 7, 2007, to discuss pertinent water right fee issues. The water board stated that to date, there has been no support for the recommended change from members of the stakeholder group. According to the water board, on January 17, 2007, the State of California Third District Court of Appeal (court) ordered the water board to revise its water rights fee regulations within 180 days of the date the court's order becomes final and to direct Equalization to provide refunds to parties where applicable. The water board asserted that the court overturned the annual water right permit and license fee because a segment of the regulated community (primarily riparian and pre-1914 water right holders) benefits from the regulatory program but does not pay fees. However, the water board stated that the court did not find the $100 minimum fee the water board charges per water right to be unreasonable. The water board stated that it and Equalization are seeking review by the Supreme Court. In the meantime, the water board states that it will continue to meet with its stakeholder group when it revises its fee regulations.

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 and again on September 5, 2006, and February 7, 2007, to discuss ➲ pertinent water right fee issues. The water board stated that to date, there has been no support for the recommended change from members of the stakeholder group. According to the water board, on January 17, 2007, the court ordered the water board to revise its water rights fee regulations. The water board asserted that the court did not express concern over the water board assessing fees based on face value of individual water right permits and licenses or over the way in which the water board addressed diversion limitations. However, the water board stated that if its stakeholder group supports the Bureau of State Audits' recommended change, the water board will consider implementing such a change in its revised regulations.

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: Partial corrective action taken.

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. By February 23, 2007, the water board stated that it had reviewed and updated 533 of the 571 pending applications in its application and environmental 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: Partial corrective action taken.

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.

Moreover, the water board stated that it convened a group of stakeholders who are concerned with pending applications in northern California coastal counties. According to the water board, this is the geographic area where the bulk of its pending applications are located. The water board indicated that the stakeholder group has discussed a number of issues related to improving the water right application and petition process, and has discussed appropriate time frames for various processes. The water board asserted that, based on these discussions, it initiated a pilot project with a subgroup of these stakeholders to simultaneously process a group of pending water right applications within a single watershed and to coordinate the environmental and technical analyses for these applications to obtain a comprehensive and expeditious conclusion. The water board asserted that it hopes this pilot project will be successful and result in a model that can be used to expedite application processing in other watersheds.

Lastly, to improve management review times, 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: Partial corrective action taken.

The water board stated that it is implementing a replacement of its existing bar-coding system with a wireless bar-coding feature to simplify and increase frequency of file inventory and reduce the number of scanning errors. The water board asserts this new wireless bar-coding scanning system will also allow file room staff to move freely around the water board to scan files on a weekly basis, providing an updated record of file locations. 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. Furthermore, the water board asserted that it conducted a complete physical inventory of its water right files and has ensured that each file has a bar code label and is scanned into the system.

Department of Water Resources

Its Administration of Grants Under the Flood Protection Corridor Program Needs Improvement

REPORT NUMBER 2007-108, NOVEMBER 2007

Department of Water Resources' response as of December 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Department of Water Resources' (Water Resources) administration of the Flood Protection Corridor Program (flood protection program). California's voters created the flood protection program by approving the Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Bond Act (Proposition 13) in March 2000. With an initial funding of $70 million, of which $57 million was available for projects, the program aims to increase flood protection, agricultural land preservation, and wildlife habitat protection throughout the State by taking various actions, such as acquiring real property interests and setting back and strengthening existing levees. The audit committee asked us to review and evaluate Water Resources' processes for selecting projects under the flood protection program. We were also asked to assess Water Resources' policies and procedures for monitoring projects and its fiscal controls over payments to grantees. In addition, the audit committee asked us to assess how Water Resources holds grantees accountable to the terms of their grant agreements and to determine whether it has properly reported on project status.

In November 2006 California's voters approved two propositions—the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006 (Proposition 84) and the Disaster Preparedness and Flood Prevention Bond Act of 2006 (Proposition 1E)—that will provide Water Resources an additional $330 million for similar flood protection projects.

Audit Highlights . . .

Our review of the Department of Water Resources' (Water Resources) administration of the Flood Protection Corridor Program revealed that:

- ***When Water Resources awarded $28 million for grants in 2001, it based the decisions on a weak selection process with poorly defined selection criteria.***
- ***It is unclear whether the highest priced grant, the acquisition of Staten Island, will result in a tangible flood protection project in return for the $17.6 million in funds awarded.***
- ***Water Resources awarded an additional $29.1 million for grants in 2003 without the aid of key information called for in its regulations to evaluate potential projects' flood protection benefits.***
- ***Water Resources has not enforced many of the monitoring procedures it established.***
- ***Water Resources has not contacted the city of Santee since March 2004, when it disbursed the final $3.65 million remaining on a $4.75 million project, despite the city's failure to submit required reports.***
- ***Water Resources neither resolved its appraisal staff's concerns nor those of the Department of General Services that the appraised value of Staten Island was too high, and as a result, the State potentially paid more than fair market value for the property.***

Finding #1: Water Resources selected projects using poorly defined criteria and made funding decisions based on incomplete information.

Decisions made by Water Resources to award first $28 million and then $29.1 million more in local grants were based on poorly defined selection criteria and incomplete information. Water Resources awarded the initial $28 million to five projects without a scoring process to consistently compare the benefits in flood protection, agricultural land conservation, and wildlife habitat protection specified in each project proposal. Although Water Resources had developed a scoring tool for this purpose, it chose not to use the tool based on the advice of its legal counsel. As a result, it is unclear why the five projects Water Resources chose to fund were better investments of Proposition 13 funds from the flood protection program than the six projects it rejected. Most notably, the flood protection program's highest priced grant, the purchase of Staten Island at a cost of $17.6 million, has yet to result in a tangible flood protection project.

When awarding $29.1 million in a second round of grants, Water Resources did not require applicants to submit two key types of information mandated in the flood protection program's regulations—hydrologic studies and evidence that owners were willing to sell their properties—for Water Resources to evaluate the relative merits of potential projects. Water Resources was also inconsistent when deciding whether to approve funding requests for structural and recreational enhancements, like pedestrian bridges and bike trails.

To provide consistency in its project selection process and to better justify its future funding decisions for the additional $330 million that it will receive from propositions 84 and 1E, we recommended that Water Resources select projects in a manner that allows it to justify its funding decisions. One way Water Resources could achieve this would be to develop and use a consistent scoring process and use the scores as a basis for making funding decisions. We also recommended that Water Resources adhere to the flood protection program regulations by requiring applicants to submit hydrologic studies and evidence that owners are willing to sell their properties. Finally, Water Resources should develop policies and procedures to consistently evaluate whether proposed structural and recreational enhancements conform to the goals of the flood protection program and are the most effective use of funds.

Water Resources' Action: Pending.

The department indicates it will implement a number of actions to improve its evaluation of proposed projects. Specifically, the department will use its existing scoring process for competitive grants to evaluate direct expenditure grants until it develops a new scoring process for direct expenditure grants. Further, the department states that it will require hydrologic studies either with a grantee's application or early in the project scope of work and provide for early termination of the project if the hydrologic study does not support the hydrologic benefits anticipated in the project application. For projects involving land acquisitions, the department now requires a willing seller letter as part of the project application and projects will not be scored without this letter. Finally, the department is developing criteria for evaluating scope changes and procedures for evaluating whether a proposed project's structural and recreational enhancements conform to the goals of the flood protection program. The department is incorporating these actions into its funding decisions for propositions 84 and 1E and expects to implement them by May 2008.

Finding #2: Water Resources has not adequately monitored projects.

Although Water Resources has established a monitoring approach that would be effective if enforced, it did not always follow good monitoring practices. Progress reports for nine of 12 projects we reviewed failed to discuss schedule and budget status, did not include records of project expenditures to support costs incurred, and did not report on any key issues affecting timely project completion. This lack of critical information has compromised Water Resources' ability to effectively monitor these flood protection program projects.

Further undermining the inadequate progress reports received was Water Resources' inability to meet its goal of regularly visiting project sites to monitor progress, inconsistent documentation of communication with grantees, and inadequate tracking of project expenditures against their budgets. Additionally, Water Resources chose not to withhold a percentage of each progress payment to grantees to ensure project completion, which may have contributed to the delays that most projects have encountered. Water Resources claims that staff turnover, staff redirection, vacancies caused by the hiring freeze, and travel restrictions due to budget restrictions contribute to these monitoring weaknesses, but its lack of formal procedures to guide staff also likely contributed to its inconsistent monitoring approach.

To effectively monitor projects, we recommended that Water Resources develop policies and procedures to ensure that it receives sufficiently detailed and complete progress reports from grantees; communicates to staff its expectations for conducting and documenting site visits; develops a process to consistently record communication with grantees; and accurately track and monitor funds disbursed to grantees. To help ensure projects are completed timely and in accordance with the grant agreements, Water Resources should withhold a percentage of payments to a grantee when appropriate and release the funds only after it is satisfied that the project is reasonably complete.

Water Resources' Action: Partial corrective action taken.

The department reports it will take several actions to improve its monitoring of projects. For example, it indicates that grantees' progress reports are now required to contain a description of actions taken since the previous report, key issues to resolve, whether the project remains on budget and on schedule, and also include supporting expenditure records. In regards to site visits, the department states it now uses a standardized site visit form and is developing a policy manual to describe program expectations, prescribed staff activities during site visits, and expected communication with grantees. Further, the department indicates hiring an analyst who will be responsible for ensuring that project budget-tracking sheets are accurate and kept up to date. Finally, the department states that it will not withhold payments for projects that are on track and where doing so would not further the program's objectives. However, the department indicates the new policy manual, which it expects to complete by May 2008, will address when it is appropriate to withhold payments from grantees.

Finding #3: Water Resources failed to adequately monitor the $5 million project with the city of Santee.

Even though Water Resources executed what appears to be a strong letter of agreement with the city of Santee, its efforts to enforce the fiscal and reporting provisions governing the project were minimal. Proposition 13 specifically earmarked $5 million to Santee for flood protection of its streets and highways, of which Water Resources withheld $250,000 for its administrative costs. We found that Water Resources had not contacted the city of Santee since March 2004, when it disbursed the remaining $3.65 million to the city. Although Water Resources' agreement with Santee required the city to submit semiannual progress reports detailing the project's progress and expenditures, we noted that Santee had submitted only two progress reports to Water Resources since November 2000, when the agreement between them was executed. Water Resources issued a letter in March 2004 asking the city to provide an accounting of its spending, but did not follow up or take any further action when it did not receive the requested information. Additionally, Water Resources has not received from Santee an audit report with an accounting of how the $4.75 million disbursed to the city was spent or a final inspection report by a registered civil engineer, even though they are required in the letter of agreement. Our inquiry of Santee resulted in obtaining expenditure records that were not always consistent with the invoices the city had previously submitted to Water Resources for payment.

We recommended that Water Resources follow up with Santee to determine how the city spent its allocated funds. Additionally, because Water Resources has not spent most of the $250,000 withheld for its administrative costs, it should release these funds to the city only after Santee demonstrates it can use the funds for flood protection purposes, provides an audit report with an accounting of how the city used the $4.75 million previously disbursed, and submits a final inspection report by a registered civil engineer as the letter of agreement with Santee requires.

Water Resources' Action: Pending.

The department indicates that the manager of the flood protection program has contacted Santee to arrange a site visit and to obtain the requested accounting and engineering reports by April 1, 2008.

Finding #4: Water Resources needs to develop a process for reporting future costs of the flood protection program.

Although Water Resources has informally reported project status in the past, it lacks an adequate internal reporting process on the flood protection program. Because the flood protection program will administer additional grants and projects with the $330 million it will receive from propositions 84 and 1E, Water Resources will need to develop processes to report to the Legislature and the Department of Finance to comply with the State General Obligation Bond Law and a January 2007 executive order from the governor that directs agencies to exhibit greater accountability over expenditures financed by bonds.

To comply with reporting requirements for projects it funds with propositions 84 and 1E, and to ensure that its management is kept apprised of key issues, we recommended that Water Resources develop a process for reporting project status. This process should include regular reporting of each project's budget and costs, progress in meeting the goals and time schedules of the grant agreement, and any key events affecting the project.

Water Resources' Action: Pending.

To improve project management, the department indicates it has implemented a software package for use on propositions 84 and 1E projects. It states that the software has an automated reporting capability and that department management will receive reports at least quarterly. However, the automated reporting capability of the software is still under development because the department has not yet selected projects for funding under propositions 84 or 1E. The department anticipates that reporting will take place at the end of each quarter and that the reports will include a variety of information on projects including issues that may affect project deliverables or schedule.

Finding #5: Although it is not legally required to do so, Water Resources has voluntarily chosen to seek General Services' advice on some land acquisition grants.

Water Resources is not legally required to obtain the advice of the Department of General Services (General Services) on appraisals for land acquisitions unless it is taking title to property valued at $150,000 or more. Nevertheless, on several occasions Water Resources did seek General Services' advice but did not always heed it, potentially resulting in overpaying for land. In the case of the acquisition of Staten Island, Water Resources did not resolve the concerns noted by its staff or General Services that the appraised value of the land was too high. Specifically, both its staff and General Services noted problems with the appraisal for Staten Island, which General Services noted at that time could be a basis for negotiating a lower overall value for the island.

To avoid paying more than fair market value for properties, we recommended that before disbursing funds, Water Resources take steps to ensure that it resolves concerns about the quality of appraisals raised by its staff, and General Services, when its advice is sought.

Water Resources' Action: Pending.

The department indicates that all appraisals are reviewed by its land and right-of-way staff or sent to General Services for review. It states that if department staff has concerns or a different opinion than General Services' staff, the conflicting opinions will now be elevated to upper management of the department for resolution. The department indicates the new policy manual, which it expects to complete by May 2008, will include the policy for resolving conflicting opinions on appraisals.

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

REPORT NUMBER 2005-120, APRIL 2006

California Student Aid Commission's response as of April 2007

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.

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.***

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

Student Aid's ability to generate an operating surplus from the 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 and EDFUND staff continue to inform and discuss with the commission and EDFUND board members the fiscal impact caused by changes in the federal Higher Education Act. Additionally, Student Aid paid the federal default fee on behalf of borrowers on loans issued from July 1, 2006, through September 30, 2006, which, according to Student Aid, accounts for the bulk of the fee incurred during the entire academic year. According to Student Aid, it determined that it would not be able to pay the fee on behalf of all borrowers for loans guaranteed on or after October 1, 2006. To remain competitive in the market, private lenders—those who provide the funds for the loans made to the FFEL Program, such as banks and other financial institutions—decided to pay the fee for loans guaranteed from October 1, 2006, through June 30, 2007. Beginning July 1, 2007, EDFUND implemented an annual default fee strategy in which EDFUND and lenders will form partnerships beginning with the 2007–08 academic year to pay the federal default fee through nonfederal sources. This cost sharing policy was designed to pay 100 percent of the federal default fee on behalf of borrowers and be open to any lender who voluntarily agreed to participate.

Furthermore, EDFUND has successfully shifted its collection strategy and has seen an increase in loan rehabilitations, wage garnishments, and voluntary borrower payments while moving away from a focus on consolidations.

However, new proposed federal changes could again affect FFEL Program revenues. As of September 7, 2007, both houses of Congress approved House of Representatives Bill 2669 (H.R. 2669), which will reduce the guaranty agency collection retention rate on borrower payments from 23 percent to 16 percent beginning October 1, 2007. H.R. 2669 also contains provisions that will reduce the account maintenance fee paid to FFEL Program guarantors from 0.10 percent to 0.06 percent of the original principal amount of outstanding loans issued by the guaranty agency. These changes are likely to significantly impact the revenues earned by FFEL Program guarantors throughout the student loan industry. The President signed H.R. 2669 on September 27, 2007.

Legislative Action: Legislation enacted.

Senate Bill 89 (SB 89), an urgency measure enacted as Chapter 182, Statutes of 2007, which took effect immediately, may affect the ownership of EDFUND. This bill authorizes the director of Finance to act as an agent for the State in the sale and transfer of the student loan guarantee portfolio and certain related assets and liabilities of the FFEL Program held by EDFUND. Alternatively, this bill authorizes the director of Finance to enter into an arrangement other than the sale and transfer of EDFUND's assets if the director, in consultation with the state treasurer, determines that arrangement will meet the goals specified in SB 89. SB 89 also prohibits the commission from authorizing EDFUND to perform any new or additional services unless they are deemed necessary or convenient by the Finance director for the operation of the loan program or for maximizing the value of the state student loan guarantee program. Similarly, the director must approve any expenditure by EDFUND. Moreover, SB 89 provides that all actions, approvals, and directions of the commission affecting the state student loan guarantee program are effective only upon approval of the director. Thus, the Finance director now has significant authority over the commission and EDFUND. Finally, the bill requires the Finance director to conduct the activities authorized by SB 89 no later than January 10, 2009.

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 Student Aid 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. We also 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's Action: Partial corrective action taken.

Student Aid's original VFA remains in place and it was successful in collecting $28 million for federal fiscal year 2005. Student Aid and EDFUND staff met with Education to discuss Student Aid's participation in the FFEL Program. However, Education has not renegotiated Student Aid's VFA or the VFAs of the other four guaranty agencies that currently have one. Student Aid officials believe that the president's proposed national budget, which would eliminate all VFAs, may have contributed to Education's not moving forward in renegotiations.

Student Aid states that when it received legislative approval to diversify its operations, the Operating Fund had sufficient cash balances to diversify. Since then, the State had redirected approximately $300 million in operating funds to pay for non-FFEL Program general fund obligations. The commissioners and board members believe that insufficient cash reserves preclude any major initiatives to diversify in the near term.

Finally, Student Aid reported that it has been working closely with a consultant and staff to delineate the roles and responsibilities of the commission, the EDFUND board, and the staff of both organizations. As a result of these efforts, the commission and EDFUND board members approved a new operating agreement and submitted it to the Department of Finance (Finance) and the Joint Legislative Budget Committee for their comment in May 2007. Furthermore, Student Aid and EDFUND finalized a roles and responsibilities document that was approved by the commission on May 1, 2007.

Legislative Action: Legislation enacted.

Senate Bill 89 (SB 89), an urgency measure enacted as Chapter 182, Statutes of 2007, which took effect immediately, may affect the ownership of EDFUND. This bill authorizes the director of Finance to act as an agent for the State in the sale and transfer of the student loan guarantee portfolio and certain related assets and liabilities of the FFEL Program held by EDFUND. Alternatively, this bill authorizes the director of Finance to enter into an arrangement other than the sale and transfer of EDFUND's assets if the director, in consultation with the state treasurer, determines that arrangement will meet the goals specified in SB 89. SB 89 also prohibits the commission from authorizing EDFUND to perform any new or additional services unless they are deemed necessary or convenient by the Finance director for the operation of the loan program or for maximizing the value of the state student loan guarantee program. Similarly, the director must approve any expenditure by EDFUND. Moreover, SB 89 provides that all actions, approvals, and directions of the commission affecting the state student loan guarantee program are effective only upon approval of the director. Thus, the Finance director now has significant authority over the commission and EDFUND. Finally, the bill requires the Finance director to conduct the activities authorized by SB 89 no later than January 10, 2009.

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.

The EDFUND board adopted EDFUND's Executive Compensation Policy in April 2007. A compensation consulting firm has reviewed the policy and the EDFUND board obtained a legal opinion from an outside law firm to ensure the policy complied with federal regulations. The policy also addresses board member conflict of interests. Although the policy was presented to the commission in April 2007, the commission determined that more information was needed before taking any action on the policy.

The EDFUND board also adopted recommended revisions to the Student Aid Policy Statement and Guidelines Memorandum for the EDFUND Incentive Compensation plans. The revisions were presented to the commission at an April 20, 2007, meeting. During the meeting, the commission approved a precondition for inclusion in the document that stated that the year-end FFEL Program revenues must exceed expenses before bonuses will be considered. The commission also determined that more information and further discussion was necessary before considering any additional revisions to the Student Aid Policy Statement and Guidelines Memorandum for the EDFUND Incentive Compensation Plan.

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 indicated that it and EDFUND have made progress in resolving the four issues identified in our report: (1) whether and how to recognize goals not achieved, (2) whether and how to recognize a percentage of accomplishment above the assigned weights, (3) whether to set a standard for acceptable variance to a goal, and (4) how midyear budget changes may affect a goal. Specifically, Student Aid states that agreement has been reached except for one area involving issues 1 and 3, which are interrelated. This area focused on the methodology that should be used to calculate turnover rate and recovery rate.

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 types 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.

On September 7, 2006, the commission 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 the board. EDFUND's spending policy also prohibits it from using corporate funds to subsidize the costs of guests participating in its employee-wide events.

Finally, the operating agreement between Student Aid and EDFUND includes a provision requiring an annual audit of internal controls by an independent certified public accountant. The operating agreement also requires the development of an annual oversight plan to monitor compliance with EDFUND policies.

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 met 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 recommended that Student Aid ensure that EDFUND follows through on its efforts to revise its contracting policies. We also 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'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.

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

Student Aid reported that it and EDFUND discussed EDFUND's 2006-07 Loan Program Business Plan and Budget with staff from both organizations to discuss policy and fiscal concerns raised by Student Aid staff. Student Aid indicated that these concerns were resolved to the satisfaction of both organizations.

Student Aid reported that it has been working closely with a consultant and its staff to delineate the roles and responsibilities of both organizations. This will include establishing the appropriate oversight responsibility of Student Aid, including procedures to verify information included in reports prepared by EDFUND.

EDFUND stated that it has completed the key tasks outlined in the June 2005 mandated performance review of EDFUND. We initially reported that six tasks had not been adequately addressed. However, during a follow-up review, we confirmed that EDFUND has completed two of six tasks. As for a third task, although Student Aid and EDFUND continued to explore business diversification options, the Student Aid commissioners and EDFUND board members agree that insufficient cash reserves precludes any major initiatives to diversify in the near term. Finally, EDFUND believes that its routine day-to-day activities address the remaining three key tasks. For example, EDFUND believes it continually reassesses its marketing strategies through the annual EDFUND Loan Program Business Plan, which includes short-term marketing goals for the upcoming year. Further, according to EDFUND, in order to assess the risk of its existing portfolio and future growth strategies, it reviews and confirms, on a quarterly basis, all financial assumptions and projections. This includes a detailed analysis of the results of operations and key business performance indicators, trends and changes that will impact the industry and EDFUND's performance in particular. Included in the review is assessing the loan volume forecasts over the various school segments and calculating the fiscal impact over a five-year period.

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: Corrective action taken.

Student Aid reported that EDFUND is maintaining closed session minutes. In addition, Student Aid reported that a policy governing closed session meetings was adopted by the commission and the EDFUND board on April 9, and April 20, 2006, respectively.

Military Department

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

REPORT NUMBER 2005-136, JUNE 2006

Military Department's response as of June 2007

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.

Audit Highlights . . .

Our review of the 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.*
- *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.*

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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 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

» *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.*

» *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.*

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. As of June 2007 the department reports that its reviews and deliberations resulted in a net conversion of 63 positions affecting 102 personnel that will eventually transition to civil service. The department estimates it will take 36 months to complete this transition. As of its one-year response, the department stated that it had reclassified 14 vacant state active duty positions as civil service positions and had downgraded another 12 active duty positions.

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 it has rewritten its regulation regarding state active duty positions. The new regulation establishes a tiered selection process and clarifies tenure status. The department stated that the new regulation would provide oversight to permanent position reviews and facilitates career management of Guard personnel by establishing a career management council (council). The council will meet at least once a year and have the capability and authority to ensure that the department provides guidance to its commanders and directors on placing the right person in the right job at the right time. The department stated that the final coordinating draft of the regulation was undergoing administrative review and the plan was to publish it in July 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. According to the department, it has received an increase in authorized full-time active guard positions for the joint forces headquarters and has reassigned staff that were previously assigned to headquarters. The department reports that as a result, as of June 2007 it had reduced full-time active guard staff assigned to the joint forces headquarters to nine positions in excess of authorized levels. 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: Corrective action taken.

The department reports that it has completed its reimplementation of a strategic planning process that involved 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.

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: 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 non-counterdrug 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: Pending.

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. The department stated it continues to work with the administration and the Legislature on a substantive benefits package to aid its recruiting and retention efforts. For example, the department is pursuing legislation that would provide tuition assistance, health care, vehicle license exemptions, state income tax exemptions, and several other credits and incentives.

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: 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 has updated 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.

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: Corrective action taken.

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.

Further, the department reports that an adequate baseline budget has been established for the maintenance and repair of its armories. The Legislature has approved a 10-year program to eliminate the backlog of maintenance and repair that will provide an annual amount of $2 million from the State's General Fund to match a $1.5 million annual amount from the federal trust fund.

Department of Corporations

It Needs Stronger Oversight of Its Operations and More Efficient Processing of License Applications and Complaints

REPORT NUMBER 2005-123, JANUARY 2007

Department of Corporations' response as of July 2007

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to review the operations of the Department of Corporations (Corporations) to ensure that it is effectively fulfilling its responsibilities. Generally speaking, we were asked to evaluate Corporations' progress toward meeting the goals and performance measures outlined in its strategic plan as well as its progress toward implementing any changes needed to fulfill its goals effectively. We were also asked to review Corporations' workload studies and fee analyses to determine the extent to which it has implemented any recommendations from these efforts. Furthermore, the audit committee requested that we evaluate Corporations' education and outreach efforts in achieving its goals.

We were also asked to evaluate Corporations' licensing policies and practices to determine if they are efficient, protect consumers, and prevent fraudulent applications from being processed. The audit committee requested that we review a sample of each type of license issued to determine whether the policies are applied consistently and to determine the length of time it takes to issue a license. It also asked that we assess Corporations' policies and practices related to the monitoring of licensees, including the number and frequency of licensee audits that are conducted and the effectiveness of the audits. Finally, we were asked to identify the number of complaints Corporations receives annually and to evaluate its policies and practices for handling complaints, including its process for monitoring the ongoing investigation of complaints, the types of enforcement actions taken, Corporations' ability to enforce actions taken as a result of complaints, and its criteria for deciding to reject a complaint or to turn it over to another enforcement agency.

Audit Highlights . . .

Our review of the Department of Corporations (Corporations) revealed the following:

- ***Corporations' current fee structure results in certain licensees subsidizing the administrative costs for others. For example, revenues from securities fees have exceeded the related service costs by $22.2 million over the last seven years.***
- ***Corporations has taken important steps in strategic planning for its operations, however, these efforts are undercut by inaccurate statistical information about its actual performance as reported in its monthly and quarterly performance reports.***
- ***Corporations does not always process applications within the time limits set by state law. In fact, for applications submitted between January 2004 and May 2006, the average processing time exceeded the time allowed by law for many of the application types we reviewed.***
- ***Although there is no legal requirement dictating the length of time Corporations has to resolve complaints, we found examples of unnecessary delays in a sample of complaints we reviewed.***
- ***Corporations has three primary information systems for capturing complaint related data; however, none of them are reliable for determining the number, type, and status of its complaints because the systems contain too many blank fields, duplicate records, and errors.***
- ***Corporations did not conduct required examinations of at least 170 licensed escrow offices and 899 licensed finance lenders within its four-year goal.***

Finding #1: The fees Corporations collects result in an inequitable distribution of charges among licensees and an excessive fund reserve.

Corporations, which does not receive support from the State's General Fund, supports its operations through revenues earned from fees charged for processing applications for notices, registration certificates, permits, and the initial issuance and renewal of licenses. We found that since 2001, Corporations has not analyzed the licensing and examination fees it charges businesses to determine whether the fees matched its costs of providing the related services. As a result, certain licensees are subsidizing costs for others because Corporations overcharges for some fees and undercharges for others. For example, revenues from securities fees have exceeded the related service costs for six of the last seven fiscal years. The amount of excess revenues from these fees ranged from $750,000 to $9.1 million and totaled $22.2 million during this time. By contrast, the service costs for nine other business activities Corporations regulates have exceeded the revenues generated from their respective fees by $21 million over the last seven fiscal years. The overcharging of certain licensees has not only covered the undercharges for other services but has also contributed to the buildup of a large reserve in the State Corporations Fund. We anticipate that this reserve will exceed statutory limits at the end of the current fiscal year.

Fees for the licenses processed by Corporations are generally set by statute. Although Corporations has limited authority to set fees below the statutory maximum for businesses that deal with certain securities transactions, offer investment advice, or act as broker-dealers, the only way it can increase fees above the statutory cap is to seek a change in the law.

To strengthen its operational oversight, we recommended that Corporations seek legislative authority allowing it to set fees by regulation. This legislative authority should require that Corporations annually assess its fee rates and establish fees that are reasonably related to its cost of providing the services supported by its fees. Corporations should also factor in the amount of any excess reserves when conducting its annual assessment.

Corporations' Action: Partial corrective action taken.

Corporations submitted a placeholder bill, AB 1516, which would have allowed the commissioner to adjust fees to reflect the actual cost of regulatory services for each law and program. However, although the Legislature preferred to maintain the existing structure outlined in statute, Corporations plans to submit a proposal in January 2008 that will change the statute to provide the commissioner limited authority to adjust fees while maintaining legislative oversight.

Corporations currently has statutory authority to make the adjustments necessary to eliminate deficits in some programs and indicated it has done so to the extent possible. For those programs where there is a cap on the assessed fee that limits its ability to make adjustments, Corporations stated it has adjusted the fee to eliminate the deficit in two fiscal years. Corporations also stated it will annually review its other rates to determine if the fees are sufficient to support program activities. If the attempt to obtain limited authority to adjust fees is denied, Corporations will request a fee adjustment from the Legislature for programs that have fees set in statute and have a deficit or surplus. Finally, Corporations stated it would review and adjust the reimbursement rate for examinations performed.

Finding #2: Corporations has made a good start on its strategic planning but needs better information about its actual performance.

Corporations has taken important steps in strategic planning for its operations, establishing a framework to identify its strengths and weaknesses with the goal of eliminating inefficiencies and increasing productivity through an examination of its current policies and procedures. Corporations' efforts include creating three interrelated documents—a strategic plan, a program-level action plan, and periodic statistical performance reports—designed to establish its goals and measure its effectiveness in meeting those goals. However, the effectiveness of its strategic planning effort is undercut by inaccurate statistical information about its actual performance as well as by the cumbersome methods used to compile the information for the performance reports. We found errors in the manual compilation of three of the 10 performance measures we reviewed. For instance, Corporations reported that the percentage of other securities regulation applications actually processed on time was 96.5 percent, but we calculated it to be 89.5 percent. Although this relatively small difference might not change Corporations' assessment of the need for change in the area, it does illustrate the need for more accurate reporting.

Corporations' systems for collecting its actual performance information are also cause for concern, because of inefficiencies and the potential for errors. Depending on the performance measure, Corporations uses both manual and automated systems to collect the information, and it then manually compiles that information for summary in a performance report. An automated system, with all necessary information accurately reported, would be more efficient and reliable. Currently, the information used to produce the reports comes from a variety of sources, such as forms, data system queries, spreadsheets maintained by team leaders, and other documents that may or may not be reviewed for accuracy. We found one instance in which staff used informal notes, rather than standard time sheets, to report the time worked on applications. Each month, certain Corporations' staff must generate statistics by performing time-consuming manual calculations and then must input the results into a separate form for the report.

To improve the efficiency and effectiveness of its system for collecting actual performance measure information, we recommended that Corporations do the following:

- Consider assessing the need for new automated data systems or determining whether its current systems are capable of collecting the necessary information.

- Ensure the accuracy and completeness of the information in its automated systems by requiring staff to enter the information and requiring supervisors to review it periodically. For data not currently available in automated format, Corporations should develop stronger procedures to ensure that staff accurately report and supervisors accurately review the information. Corporations should consider calculating and reporting performance measures quarterly, rather than monthly, until it has a more efficient data collection system.

- To ensure that it has identified all necessary performance measures and appropriately focused its current performance measures, Corporations should continue to assess the reasons for performance deficiencies and add or adjust performance measures as needed.

Corporations' Action: Partial corrective action taken.

Corporations indicated it has met with the Department of Finance (Finance) to discuss the process to obtain or update its automated data systems and has issued a Request for Proposal for a needs assessment and feasibility study. Corporations also expects a contractor to soon begin the needs assessment and prepare a feasibility study report and expects to submit the report to Finance by January 2008. According to Corporations, databases have already been created to capture significant dates in the application process and the initial use of the databases began in June 2007.

Corporations indicated it has implemented procedures that require staff to confirm the accuracy of information posted in its automated systems prior to exiting the system. Further, Corporations stated that under its new procedures managers or supervisors will review source documents on a sample basis and ensure that information on the source documents matches information in the electronic file. The procedures also direct managers and supervisors to review their automated systems monthly for blank fields and request that staff research and complete the data fields with the appropriate information. Further, Corporations indicated that managers will counsel and provide training to employees who consistently make errors when posting information to the automated systems.

Additionally, Corporations stated that it modified its procedures that allowed more than one complaint file to be created in the data system for the same complaint. Among other things, these procedures require a supervisor to review the listing of complaints for duplicate files. Additional procedures are also being developed for the review of other data related to complaints. Finally, under its modified procedures Corporations stated its legal counsel will perform a monthly review of the data fields in the Enforcement Case Management System to ensure that all fields are completed and any deficiencies will be discussed with the assigned counsel and the correct information will be posted in the system.

Corporations indicated that the Securities Regulation Division (securities division) has completed an initial review of performance measures to identify deficiencies and determine what caused the deficiencies and develop corrective action plans to meet performance measures. According to Corporations, the securities division will also re-evaluate performance measures, baselines and targets for appropriateness and accuracy. Managers will evaluate and report quarterly to executive staff performance deficiencies and their corrective action plans.

Corporations stated that the Financial Services Division (financial division) will review and monitor processing times and compare them with benchmarks on a quarterly basis. Further, the financial division will develop corrective measures to address any issues identified and develop new, more appropriate measures that are achievable.

Finding #3: The effectiveness of Corporations' outreach unit is uncertain.

Corporations does not collect enough data or identify sufficient goals to effectively assess its education and outreach efforts. One of Corporations' Education and Outreach Unit's (outreach unit) primary programs is its Seniors Against Investment Fraud (seniors program), which is designed to educate senior citizens about investment fraud and how to protect their finances from predatory schemes. In its budget change proposal for fiscal year 2005–06, Corporations requested $400,000 in ongoing permanent funding for the seniors program (and received $225,000). The proposal identified 12 performance measures intended to aid Corporations in evaluating the achievement of the objectives of the seniors program. However, Corporations does not collect data for four of these measures. For example, when it sought funding for the program in fiscal year 2005–06, Corporations stated that it planned to track the number of seniors program volunteers by geographical area; it had not done so as of December 2006. Corporations does not track any data for three other performance measures because, according to the director of the outreach unit, the measures are not clear. Further, although Corporations collects data for eight of the 12 performance measures, it measures its effectiveness for only two—the number of publications disseminated and the number of presentations given—by comparing them to established goals. However, without sufficient data and relevant benchmarks, it is impossible for Corporations to effectively assess its overall performance in protecting senior citizens from investment fraud.

Moreover, Corporations has not developed any formal goals to effectively measure the success of its other primary program—the Troops Against Predatory Scams Investor Education Project (troops program). The troops program was funded by a grant that requires that Corporations collect data and report the results on seven performance metrics. However, Corporations has not established any formal benchmarks to gauge whether or not its efforts were successful. As a result, Corporations cannot assess whether the program is achieving the desired results.

To ensure that the outreach unit can effectively measure its success, we recommended that Corporations should ensure that it collects all of the necessary data and establishes reasonable benchmarks.

Corporations' Action: Corrective action taken.

According to Corporations, in January 2007, the outreach unit developed a monthly reporting form that will capture the number of seniors program partners and training kits distributed. Corporations also stated that the outreach unit also revised existing performance measures and benchmarks based on relevancy and accuracy. The outreach unit eliminated six of the existing 12 performance measures and replaced them with four new performance measures. Data will be collected monthly and measured against the benchmarks.

Finding #4: Corporations does not always process applications within the time limits set by state law.

State law requires Corporations to assess the completeness of applications and notify applicants in writing of any deficiencies in the applications within specific time frames, and either issue or reject the application within a specified time period. We found that Corporations does not always process applications within the time limits set by state law. For example, of the 35 applications we reviewed, we noted 10 instances where Corporations did not comply with the statutory time frame for processing applications. Delays could result in entities being unable to conduct business. Delays may also increase the likelihood that businesses will conduct unlicensed financial transactions. However, while Corporations is responsible for the delays in processing some license applications, other factors outside of its control also contribute to lengthy processing times. For instance, license applicants do not always provide the required information when submitting applications. Deficiencies in applications and delays in correcting them create additional work for Corporations' staff and can substantially delay the issuance of licenses. We found that Corporations issued deficiency notices for 32 (91 percent) of the 35 applications we reviewed. Although application requirements can be somewhat daunting, they did not appear to be overly complex. According to Corporations, these delays generally occurred because of a backlog resulting from a large increase in the number of applications submitted in recent years and some applications requiring a more extensive review.

In addition, Corporations does not have complete data for some of its license applications. We found that the application system data related to corporate securities and franchises contain omissions and inaccuracies, hampering Corporations' ability to compile accurate performance statistics.

To ensure that all applications are reviewed promptly and sufficiently, we recommended that Corporations do the following:

- Continue to monitor the progress of applications through the review and approval process to identify any that have stalled, and investigate the reason for the delay.
- Follow the law in notifying applicants once their applications are complete.
- Follow up with applicants that do not promptly respond to deficiency notices.
- Assess whether it needs additional staff to process applications.
- Maintain all necessary data in its information management systems so that it can effectively calculate the number of days it takes to process applications.

Corporations' Action: Partial corrective action taken.

Corporations stated that it reviewed its procedures for processing applications submitted to its securities division in order to streamline the process to focus on the most critical factors in an application. According to Corporations, this process, along with hiring a retired annuitant, has significantly reduced the backlog of applications pending review.

Additionally, Corporations stated that the financial division has revised its procedures for processing applications to include having staff notify supervisors when an application has stalled. The reason for any delays will be determined and corrective action taken. Managers will also review a log or aging schedule to determine if any applications have stalled. These revised procedures will be written and included in an applications procedures manual. Further, Corporations indicated that it has developed and will maintain the data necessary to calculate the number of days it takes to process applications.

According to Corporations, it has revised the letter it sends to applicants notifying them that their application has been approved. The revised letter will now include both a reference that the application is complete and has been approved. Corporations also stated that it has developed a tracking mechanism that notifies staff at established intervals that an applicant has not responded to a deficiency notice. In these instances Corporations stated that staff will prepare a follow-up letter notifying the applicant that Corporations will close the application if the requested information is not received by a given date. A second notice will be sent if the information is not received and, if no response is provided, Corporations will close the application.

Corporations indicated that it is in the process of identifying the average number of staff needed to handle its normal workload. Corporations will also review the log of outstanding applications to determine if it is necessary to redirect resources, if possible, to prevent a further buildup of applications. Additionally, Corporations stated it is developing an overall plan to determine if additional resources are needed in various program areas and, if so, will seek those additional resources in the budget process.

Finally, Corporations stated that it has developed policies and procedures for ensuring that all applications received are logged for date of receipt, date approved/license issued, and the number of days for completion. The policies and procedures also require documenting the reasons for any extraordinary issues that delay processing.

Finding #5: Corporations is working to improve its handling of complaints.

Either the securities division or the enforcement division typically handles complaints related to securities regulation. Of the 20 complaints related to securities regulation we reviewed that were closed between May 20, 2005, and July 18, 2006, nine were referred to the securities division. It took the securities division an average of 312 days, ranging from 55 to 531 days, to resolve these nine complaints. The remaining 11 complaints related to securities regulation were referred to the enforcement division and took an average of 170 days to resolve, ranging from 20 days to 383 days.

The time Corporations takes to resolve complaints is contingent on many factors. For instance, the complexity of the case, the availability of staff, and the time it takes for complainants to respond to Corporations' inquiries all may contribute to the length of the process. Moreover, there is no legal requirement dictating the length of time Corporations has to resolve complaints. Thus, we expected the number of days Corporations took to resolve securities regulation complaints to vary depending upon the circumstances of each case. Nonetheless, during our review, we identified four complaints in which unnecessary delays increased the length of the process. For example, the securities division did not begin its investigation of one complaint until 277 days after the complaint was received. In another instance, the enforcement division took 176 days to refer a complaint to the securities division for further action, during which time nothing was done to address the complainant's concerns. Corporations' management could not explain these delays.

Moreover, we reviewed a sample of 20 complaints related to financial services that were closed between November 29, 2004, and August 8, 2006. We found that Corporations took between 35 and 232 days to close these complaints, averaging 106 days. Unlike its process for handling complaints related to securities regulation, Corporations handles financial services complaints by sending letters to licensees requesting them to respond in writing to the complaint allegations within 15 days. Delays can occur if the licensee does not respond within the 15-day time frame. However, we found some instances in which unnecessary delays on Corporations' part increased the length of the process. For example, in four of the 20 complaints we reviewed, Corporations took between 34 and 210 days to send letters to the complainants notifying them that it had begun its review, exceeding its 30-day goal. In two of the four cases, Corporations' staff did not forward the complaints to its financial division for handling for 28 and 38 days, respectively. However, Corporations' staff forwarded the two remaining cases in less than six days.

Corporations has recently modified its procedure for handling complaints. In addition to developing formal policies for rejecting and referring complaints, it has centralized the intake of all complaints by forwarding them to a new complaint team. Corporations believes that this new process will allow it to respond immediately to complaints and prepare each complaint for referral to the appropriate division. Because Corporations initiated this process near the end of our fieldwork, we were unable to test whether it will correct any of the weaknesses we identified. However, it appears that the process contains good business practices.

To improve the efficiency of its complaint-handling process, we recommended Corporations do the following:

- Develop procedures to track the progress of complaints to ensure that they continue to move through the process without unnecessary delay.

- Monitor its newly established complaint-referral process and develop procedures, if necessary, to decrease the length of time it takes to refer cases to the appropriate division.

Corporations' Action: Corrective action taken.

Corporations stated it established a complaint team in August 2006 that revised the processing of complaints. As a result, Corporations stated that the time to respond to a complaint has been shortened. The complaint team also developed a monthly report that tracks the number of complaints received, the backlog of complaints, responses to complainants, and the average number of days it takes to process complaints. Additionally, Corporations stated that the enforcement division has developed plans and goals that involve completing case investigations and either taking action or closing a case, as appropriate.

Corporations stated it will continue to monitor its complaint-referral process to look for additional ways to decrease the timeframes for processing complaints. Additionally, an executive staff member will review the complaint-referral procedures and protocols and provide recommendations to the commissioner on how to improve the process.

Finding #6: Information systems containing data regarding complaints are unreliable.

Although it has three information systems for tracking complaint data, Corporations undercuts these efforts by failing to ensure that any of the three systems contain reliable data. Several of the critical data fields in Corporations' Customer Relationship Management (CRM) system and Corporations' Customer Service System (CSS) were often left blank, limiting the usefulness of these systems as management tools. For example, the fields needed to calculate complaint processing times, such as date received, date assigned, and date opened, were blank 9.5 percent, 25 percent, and 68 percent of the time, respectively, for the CRM system. Consequently, these fields cannot be used to determine where a complaint is in the resolution process or to monitor and evaluate complaint-processing times. In addition, we found that the field identifying the specific law a complaint was related to was left blank for more than 24 percent of the 2,876 complaint records in the CSS and for 50 percent of the 2,461 complaint records in the CRM system. Without this information, Corporations cannot determine how many complaints it receives about alleged violations of various laws and cannot effectively identify problem areas or adjust its workforce to handle them.

Moreover, we found several types of data entry errors in Corporations' complaint systems. For example, the CRM system did not reflect the correct status for many of the complaints we reviewed. The status field can be used to indicate the disposition of a particular case, such as closed, in progress, or referred. However, the CRM system listed an incorrect status for 13 of the 20 complaints we reviewed. In each of these cases, the CRM system indicated that the case was still in progress, even though all of them had been closed. Thus, Corporations cannot rely on the system to determine the number of complaints still in progress, completed, or referred to another division. We also found that the CRM system did not reflect the correct date received for eight of the 20 complaints we reviewed. Specifically, the date entered into the CRM system as the date received did not agree with the supporting documentation for four of these complaints, and it was left blank for the others. Similarly, we found data entry errors for the field intended to capture the date a complaint was received in three of the 20 complaints we reviewed in the CSS. In addition, six of the 34 enforcement actions we tested in the Enforcement Case Management System reflected an incorrect date for when the action occurred, limiting the usefulness of the system as a management tool.

To improve the usefulness of its information systems, we recommended that Corporations review its existing complaint records and eliminate duplicates and correct any inaccurate fields. Further, Corporations should maintain accurate and complete data to ensure that the information systems can be used more effectively as management tools.

Corporations' Action: Pending.

Corporations did not fully address our recommendations in its response. Specifically, it noted that the enforcement division is reviewing its case management system to determine how to improve it. Options include using more fields of data and creating reports that would capture data to assist management using trends and workload issues. However, its response did not directly address our recommendation to review its existing complaint records and eliminate duplicate records and correct any inaccurate fields.

Finding #7: Corporations failed to perform required examinations of some licensees.

Corporations did not conduct examinations of many of its escrow licensees within the time frames required by law. Additionally, Corporations did not conduct examinations of its licensed finance lenders as frequently as required by its internal policy. Consequently, Corporations' ability to protect consumers against potential fraudulent lending and financing scams was weakened.

The California Financial Code requires Corporations to conduct examinations of licensed escrow offices and mortgage lenders at least once every four years. In addition, although not required by law, Corporations has established a goal for examining every licensed finance lender at least once every four years. However, Corporations did not conduct examinations of many escrow offices and finance lenders within the last four years. Specifically, we found that at least 170 licensed escrow offices and 899 licensed finance lenders—representing 37 percent and 35 percent, respectively, of all such licensees that required examinations—have not had an examination for at least four years. Corporations was more effective with its examinations of mortgage lenders; only two licensed mortgage lenders—less than 2 percent—did not receive the required examination within at least the last four years.

Corporations also lacks clear guidance for conducting examinations and following up on the deficiencies it identifies. For example, it does not have any policies or procedures on the time frames within which examiners must follow up on licensees' responses to deficiencies identified during an examination. In a sample of 20 examinations performed by the financial division, Corporations' examiners identified a total of 112 deficiencies related to 17 of the examinations; the remaining three did not identify any deficiencies. The identified deficiencies included improper charges, unauthorized disbursements from accounts, and altered checks. When we followed up on six of the 17 examinations that identified deficiencies, we found that in four cases the examiners took between 79 days and 187 days to provide a response to the licensees after they had responded to the deficiencies. We expected Corporations to have established response time frames to ensure the prompt resolution of any deficiencies.

We recommended that Corporations develop a plan to conduct examinations of licensees in accordance with state law and its own internal policy. Corporations should also establish clear guidance and response time frames for following up on deficiencies identified in examinations.

Corporations' Action: Partial corrective action taken.

Corporations stated that it has identified the number of licensees that need to be examined based on statutory requirements or internal policy, as well as the average hours per exam. Additionally, Corporations received 30 additional examiner and enforcement positions in the fiscal year 2007–08 budget. Nevertheless, Corporations stated it will evaluate current staffing levels to determine whether sufficient staff exists to perform the required exams. If staffing levels are insufficient after staff redirections from other programs, Corporations stated it will pursue additional staffing through the budget process. Corporations also indicated that it developed procedures in September 2007 to review enforcement actions taken to determine compliance by licensees, to evaluate the enforcement action, and to identify high-risk candidates for follow-up non-routine examinations.

California Department of Corrections and Rehabilitation

It Needs to Improve Its Processes for Contracting and Paying Medical Service Providers as Well as for Complying With the Political Reform Act and Verifying the Credentials of Contract Medical Service Providers

REPORT NUMBER 2006-501, APRIL 2007

California Prison Health Care Receivership Corporation's[1] response as of November 2007

The state auditor has the authority to audit contracts involving the expenditure of public funds in excess of $10,000 entered into by public entities, at the request of the public entity. The court-appointed receiver requested that the Bureau of State Audits (bureau) conduct an audit of a variety of issues related to existing contracts between the California Department of Corrections and Rehabilitation (Corrections) and certain medical care providers. Specifically, the receiver requested that the bureau review Corrections' processes for procuring medical registry services and its practices involving these services for fiscal year 2005–06 and to determine whether the process is fair and adequate and complies with all applicable laws and regulations, whether the language used in medical registry contracts is adequate and complete and written in the best interests of the State, and whether conflicts of interest exist related to procuring the medical services.

Additionally, the bureau was asked to examine Corrections' medical registry contracts and payment practices for fiscal year 2005–06 and to determine whether contractors comply with the terms and conditions of the contracts, and whether Corrections' accounting and payment practices for contracts comply with laws, regulations, and industry practices. Finally, the bureau was directed to review the medical registry contracts and compare the rates Corrections pays contractors with the amounts the contractors pay their medical care providers, and to determine whether the contractors and medical care providers rendering services in the prisons meet all applicable licensing and certification requirements.

Audit Highlights . . .

Our review of the California Department of Corrections and Rehabilitation's (Corrections) contracts for medical services revealed the following:

- *Corrections improperly awarded nine of 18 competitively bid contracts with a total maximum amount of more than $385 million.*
- *Corrections did not provide complete justifications for awarding two noncompetitively bid contracts totaling almost $80 million.*
- *Some aspects of Corrections' treatment of some medical providers raises concerns about whether they are, in fact, treated more as employees than independent contractors, which may expose the State to potential liability and penalties.*
- *Only 16 of the 21 contracts we reviewed contained terms that meet the standard of medical care called for in Corrections' regulations.*
- *Many of the contracts we reviewed did not contain terms that Corrections considers standard in medical service contracts to adequately protect the confidentiality, privacy, and handling of inmate medical records under the federal Health Insurance Portability and Accountability Act.*
- *Although all contracts in our sample gave Corrections the ability to inspect and monitor the quality of contractor performance, only five of the 21 contracts imposed a similar obligation on the medical care service providers.*

continued on next page . . .

[1] In May 2005, four years after the Plata Davis (Plata) lawsuit was filed, and after meeting regularly with the parties to the Plata settlement, the court conducted hearings to determine if it was necessary to appoint an interim receiver. In February 2006 the court appointed a receiver. The court order making the appointment gave the receiver the authority to "provide leadership and executive management of Corrections' medical health care delivery system with the goal of restructuring day-to-day operations and developing, implementing, and validating a new, sustainable system that provides constitutionally adequate medical care to all members of the class action lawsuit as soon as practicable." To achieve those goals, the receiver has the duty to control, oversee, supervise, and direct all administrative, personnel, financial, contractual, legal, and other operational functions of Corrections' medical health care delivery system. In making these recommendations to Corrections, we understand that they would be implemented at the direction of the court-appointed receiver. We do, however, expect that if control and management of Corrections' medical health care delivery system is returned to it, that Corrections would then become responsible for implementing these recommendations.

» *Corrections overpaid registry contractors by $4,050 for five invoices because prisons did not consistently ensure that payment amounts agreed with contract terms.*

» *Corrections failed to ensure that prisons require their consultants to complete statements of economic interests or to document why it was appropriate for them not to do so.*

» *Corrections did not verify the credentials of providers who treat inmates outside of Corrections' facilities because it incorrectly believed these reviews were being conducted by the Department of Health Services.*

» *Of the 22 physicians and nurse practitioners for which we requested credentialing files, Corrections was only able to provide 12. Of these 12, eight were credentialed after they had begun providing services to inmate patients.*

Finding #1: Corrections did not always award contracts according to state policy or its own policy.

Corrections awarded nine of 18 competitively bid contracts incorrectly. Specifically, in awarding these nine contracts, Corrections assigned incorrect hierarchy positions to bidders, primarily because its practice was to apply the small business preference—a 5 percent preference given to small businesses bidding on state contracts—to the bidders' hourly rate rather than the bid price. As a result, for seven contracts Corrections failed to limit the preference to $50,000, as state law and regulations require, and for all nine contracts it gave bidders a larger preference than allowed, causing some bidders to incorrectly receive higher-ranking positions.

Corrections uses a cost threshold to limit the number of contract awards for its registry contracts but it does not have any written policies or procedures for determining the cost thresholds. Additionally, Corrections' solicitation documents did not inform the bidders of its use of a cost threshold or its methodology for calculating the threshold. Further, Corrections did not always apply the cost thresholds properly according to its stated methodology and, as a result, improperly awarded one contract and excluded another bidder from the opportunity to provide services. Finally, we found that Corrections did not always calculate the cost threshold using the methods it described to us and based on our calculations, it improperly awarded contracts. When Corrections does not apply the small business preference or its cost threshold properly, it may be unfairly preventing contractors from providing registry services or selecting contractors who do not meet its criteria.

We recommended that Corrections ensure that staff receive proper training on bidding methods, including the appropriate application of the small business preference, so that bidders are awarded contracts in the correct order. We also recommended that Corrections establish policies and procedures for determining the cost threshold used to limit the number of awards made to registry contractors and implement a quality control process to ensure staff calculate the cost threshold correctly and retain documentation to support their calculations in the contract files. Further, we recommended that Corrections notify potential bidders of its use of a cost threshold to determine the awards to be made and its methodology for calculating the threshold. Finally, we recommended that Corrections implement a quality control process to identify errors in the ranking of bidders before awarding contracts.

Corrections' Action: Partial corrective action taken.

According to the Office of the Receiver, it plans to change its process to ensure that the small business preferences are correctly applied. The Office of the Receiver also stated that it agrees that staff should receive additional training on bidding methods and its managers are currently providing informal training in the area of bidding and application of small business preferences. The Office of the Receiver plans to develop formal training materials by March 2008 and anticipates commencing formal training in April 2008.

The Office of the Receiver does not believe it is appropriate or feasible to establish policies and procedures regarding the methodology for determining the cost threshold used to limit the number of awards made to registry contractors. However, the Office of the Receiver stated that it will bring the issue to the attention of the consulting firm who will advise the Receiver regarding the organization of the Contracts Unit.

Regarding our recommendations to (1) implement a quality control process to ensure staff calculate the cost threshold correctly and retain documentation to support their calculations in the contract files and (2) notify potential bidders of its use of a cost threshold to determine the awards to be made and its methodology for calculating the threshold, the Office of the Receiver stated that it will take the recommendations into consideration when developing the policies and procedures. The Office of the Receiver anticipates completing the policies by March 2008 and commencing formal training for staff in April 2008.

Finally, the Office of the Receiver stated that it reissued a Request for Proposals in October 2007 to secure services of a consulting firm to advise on implementation of a quality control unit. The Office of the Receiver hopes to be in a position to evaluate and implement the consultant's recommendations by June 2008. In the interim, it developed a revised spreadsheet in July 2007 to rank bidders and there is also a pending upgrade to its software to perform this function automatically by March 2008.

Finding #2: Corrections' justifications for awarding two competitively bid contracts were incomplete.

State policy requires a minimum of three competitive bids except in certain circumstances. Corrections did not always retain complete justifications for awarding contracts when receiving fewer than three bids. Specifically, for two of 18 competitively bid contracts, Corrections did not receive three bids and did not justify the reasonableness of the award amounts. Also, although Corrections advertised these two contracts in the California State Contracts Register, it could not demonstrate that it solicited all known potential contractors as state policy requires. Consequently, Corrections was not exempt from complying with state policy requirements for awarding contracts with fewer than three bids.

We recommended that Corrections fully comply with state policy, including justifying and documenting the reasonableness of its contract costs, when it receives fewer than three bids. We also recommended that Corrections retain documentation of its efforts to solicit all known potential contractors when it advertises in the California State Contracts Register.

Corrections' Action: Partial corrective action taken.

According to the Office of the Receiver, it is setting appropriate rate structures for various disciplines in order to justify reimbursement and its process includes surveying state salaries and contract rates. Additionally, the Office of the Receiver stated that there is a system currently in place to document known providers. Finally, the Office of the Receiver stated that it will take these recommendations into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008.

Finding #3: Corrections could not justify the prices contained in two noncompetitively bid contracts.

Corrections did not retain justifications for the rates found in two of three noncompetitively bid contracts we reviewed. For one contract, with a maximum amount of almost $79 million, Corrections did not have documentation to support that the rates determined were fair and reasonable. For the second contract, with a maximum amount of $1 million, Corrections obtained approval from the Department of General Services (General Services) using a special category noncompetitively bid exemption request. However, Corrections was unable to produce documentation to support compliance with specific conditions of approval including following the price analysis and methodology requirements of the special category exemption. When Corrections does not justify and document the reasonableness of the contract rates it agrees to pay, in accordance with the methodology approved by General Services, it is unable to demonstrate that the rates are appropriate and reasonable.

We recommended that Corrections fully comply with state policy including justifying and documenting the reasonableness of its contract costs when it chooses to follow a noncompetitive process. We also recommended that Corrections adhere to the price analysis and methodology approved by General Services when using the special category noncompetitively bid request process. For example, it should use Medicare rates as a benchmark for determining the reasonableness of its rates paid to contractors.

Corrections' Action: Pending.

According to the Office of the Receiver, it is setting appropriate rate structures for various disciplines in order to justify reimbursements and its process includes surveying state salaries and contract rates. The Office of the Receiver also stated that it will take this recommendation into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008.

According to the Office of the Receiver, although Medicare is not applicable to registry contracts, it has one report and is in the process of obtaining an additional report from a consultant to validate its transition to Medicare for non-registry contracts. The Office of the Receiver is also in the process of determining appropriate reimbursement structures for various services and its process includes surveying the community for similar service costs.

Finally, the Office of the Receiver stated that it will take this recommendation into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008.

Finding #4: Corrections paid some contractors for services provided before their contracts were approved by General Services.

For four contracts we reviewed, we noted seven instances, totaling almost $20,000, in which registry contractors were performing service at prisons before Corrections obtained General Services' final approval of the contracts. When Corrections does not ensure that it obtains proper approval before allowing contractors to perform services, it exposes the State to potential litigation if General Services does not approve the contract.

We recommended that Corrections ensure that it establishes internal control processes that prevent prisons from allowing contractors to perform services before receiving General Services' approval of the contract.

Corrections' Action: Pending.

The Office of the Receiver stated that it will take this recommendation into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008.

Finding #5: Some contracts did not contain Corrections' standard contract terms.

Three of 21 contracts in our sample did not contain terms that required Corrections to provide 24 hours notice to a medical registry if services had been scheduled but were not needed for a particular shift. Our legal counsel advised us that the reviewing court would likely find that reasonable notice would be an implied term of the contract. However, litigation can be averted if the parties define what constitutes reasonable notice in the contract.

We recommended that Corrections' medical registry contracts contain express provisions related to the required notice period for cancellation.

Corrections' Action: Pending.

The Office of the Receiver agrees with this recommendation and stated that by May 2008 it will ensure standard language pertaining to the cancellation of medical services is developed and included in new contracts.

Finding #6: Some contracts lack Business Associate Agreements that ensure compliance with federal requirements related to privacy, confidentiality, and transfer of inmate medical records.

Under the Health Insurance Portability and Accountability Act (HIPAA), Corrections may act as a covered entity in the provision of medical care to inmates and the various contractors with whom it does business may act as "business associates." As business associates, those contractors are obligated to follow HIPAA, which imposes various obligations related to the confidentiality and handling of prisoner medical information. HIPAA also requires that a business associate enter a Business Associate Agreement that imposes specific obligations designed to ensure compliance with HIPAA. Only six of 21 contracts we reviewed contained the required Business Associate Agreement.

We recommended that Corrections include Business Associate Agreements in all contracts subject to HIPAA and amend existing contracts to include those agreements.

Corrections' Action: Pending.

The Office of the Receiver agrees with this recommendation and stated that by May 2008 it will ensure standard language pertaining to the areas covered by HIPAA is developed and included in new contracts.

Finding #7: Corrections' treatment of its independent contractors raises concerns about whether they are, in fact, employees.

Although all the contracts in our sample contained terms that indicate medical registries act as independent contractors, we surveyed each of the contracting medical registries in our sample to evaluate their relationship with Corrections based on 20 general factors that the U.S. Department of the Treasury, Internal Revenue Service (IRS), uses to determine whether a worker is an employee or an independent contractor. Most of the contractors noted that they are not required to comply with specific instructions from Corrections on how to perform their services and half noted that they pay their workers directly, rather than having them paid by Corrections, which indicates a level of autonomy associated with that of an independent contractor. Other factors, however, suggest several areas in which Corrections appears to maintain a significant degree of control over the manner and means of performing the work. We noted that the IRS and the courts do not expressly state a single, definitive rule regarding what constitutes an independent contractor. Instead, the courts and the IRS make each decision based on the totality of the circumstances. As such, it is difficult to say whether medical registries would be deemed independent contractors or Corrections' employees.

Potential liability and penalties for misclassification of an employee include substantial taxes, back pay, and reimbursement of expenses. Furthermore, California does not make a distinction between intentional and unintentional misclassification of an employee. Thus, the responsibility for proper conduct and classification of an independent contractor falls upon the employer.

To ensure that there is no uncertainty surrounding the legal status of contract employees, we recommended that Corrections seek expert advice and legal counsel to determine whether its current treatment of certain medical registry service providers is such that those medical registry service providers should be considered employees rather than independent contractors.

Corrections' Action: Partial corrective action taken.

The Office of the Receiver stated that the issue as to whether or not registry employees are employees versus independent contractors is a statewide issue that will be referred to the State Personnel Board. This question has statewide implications and is beyond the scope of the Receiver.

The Office of the Receiver also stated that it is in the process of hiring full-time permanent civil service clinical staff, and there will be, over time, an elimination or significant reduction in Corrections' reliance on registries.

Finding #8: Contract terms related to the standard of care are inconsistent and sometimes ambiguous.

All 21 contracts in our sample contained terms related to the standard of care. However, only 16 contained terms that appear to meet the legally required standard contained in regulation. Even then, the language used to describe the standard of care in these 16 instances varies widely. Despite this variation, we considered all these terms to be essentially the same in that they appeared to call for the legally required standard of care set out in regulation. In four other contracts, the contracts contained terms that appear to have been drafted in an attempt to be consistent with the standard of care set out in regulation, but rather than requiring the contractor to meet that standard, they required the contractor to provide medical care "necessary to prevent death or permanent disability." According to our legal counsel, this language does not meet the minimum standard set out in regulation and appears to establish a potentially lower standard of care. In addition, one contract contained only a requirement that the contractor provide services consistent with scope of practice and did not prescribe a standard that was specific to a prison setting.

We also noted that many of the contracts in our sample contained multiple terms related to the standard of care within the same contract. In some cases, these terms appear to be inconsistent with one another. For example, 14 of 21 contracts contained terms requiring contracting medical care providers to follow the legally required standard in regulation and to follow generally accepted professional standards or national standards. We do not in any way question the value of following generally accepted professional standards or national standards. However, because it is not necessarily clear that Corrections' regulatory standard and the standard of care called for by professional or national standards are the same, this inconsistency may create an ethical dilemma and confusion on the part of medical care providers and may even result in litigation. We also noted a lack of consistency across our sample in terms of the standard of care being required. For example, only seven of 21 contracts required the contractors to meet national standards.

Finally, we found that some contracts contained terms related to the standard of care that were inconsistent with the American Medical Association's (AMA) recommendations. The AMA recommends that a contracting physician not obligate himself or herself to a standard of care that is higher than that required by law. Several contracts we reviewed called for the provider to meet Corrections' standard of care and called for "high quality" or even the "highest level of treatment within the scope of available resources" as the standard of care. Although we do not in any way question the importance of providing high-quality medical care to inmates, drafting contracts containing multiple terms that may suggest differing standards of care creates an ambiguity that may result in uncertainty on the part of the provider, and potential disagreement among the contracting parties, about just what is required under the contract.

We recommended that Corrections' medical registry contracts contain clear and consistent requirements related to the standard of care called for under the contract. At a minimum this standard of care must meet the standard of care needed in order to satisfy Corrections' obligations under the Plata settlement agreement. Also, to ensure that Corrections' contracts contain terms for standard of care that meet its constitutional obligations as well as the standard of care that a practicing physician would provide if adhering to generally accepted ethical norms, Corrections should seek legal counsel and other expert advice to determine whether the standard of care currently prescribed in state regulations allows contracting physicians to provide medical care in a manner that is consistent with the generally accepted standard of care in the medical community. If the standard of care is not consistent with the generally accepted standard of care in the medical community, Corrections should revise its regulatory standard to require that the standard of care called for in the State's prisons is, at a minimum, consistent with medical ethics and with the State's constitutional obligations.

Corrections' Action: Partial corrective action taken.

According to the Office of the Receiver, it will ensure that Corrections' contracts include constitutional levels of care for prisoners, as the Receiver's mandate is to establish constitutional levels of medical care in California's prisons. However, the remainder of the recommendations that involve community standards of care may be more suitable for state consideration after the Receiver's work is completed and authority over Corrections' medical system is returned to the State.

Finding #9: Contract terms should impose clearer obligations for contractors to be insured against civil rights claims.

We found that all the contracts we reviewed called for the recommended level of liability coverage as specified by the State. However, although some of the contracts contained terms requiring the contractor to notify the insurance carrier that the contractor regularly provides services to inmates, it is not clear that this term necessarily would ensure that the contractor was insured against civil rights claims.

We recommended that Corrections require medical registries to submit proof that their insurance company has agreed explicitly to insure them against civil rights claims.

Corrections' Action: None.

According to the Office of the Receiver, no evidence has been provided that this recommendation is based upon specific cases of monetary loss. For example, no evidence has been submitted that the State has experienced losses due to civil rights violations by registry personnel. The Office of the Receiver states that while it agrees that a contract provision requiring an insurance company represent clinical registries concerning civil rights claims may seem desirable in theory, this requirement in practice is not one of the Receiver's top priorities for several reasons, including the following: (1) mandating such a clause may drive up the cost of registry contracts to a degree that is not fiscally justified; (2) private insurance carriers may not offer civil rights coverage because civil rights liability is, under certain circumstances, driven by "deliberate indifference" rather than negligence; and (3) given the existing unconstitutional conditions at many prisons, the insurance carrier may defend claims against registry staff by cross-complaining against the State because of the situation the registry clinician was placed. Therefore, we do not intend to implement this recommendation at this time.

Finding #10: Although many contracts require Corrections to inspect and monitor performance, few impose obligations on contractors to monitor or assess their quality of service.

All of the contracts in our sample enabled Corrections to inspect and monitor the quality of contractor performance. However, only five contracts imposed a corresponding obligation on the part of medical registries to monitor and assess the quality of their own performance.

We recommended that Corrections require registry contractors to monitor and assess the quality of services they provide under the contract.

Corrections' Action: None.

The Office of the Receiver stated that while it agrees that a contract provision requiring registries to monitor and assess the quality of their services may seem desirable in theory, in practice this requirement is not one of the Receiver's top priorities for several reasons, including the following: (1) mandating such a clause may drive up the cost of registry contracts to a degree that is not fiscally justified; (2) the monitoring and assessing of quality is a Receivership function and should not be delegated to private providers; and (3) there is no guarantee that the registry will perform this task adequately and therefore the Receiver will need to monitor the monitoring by the registry, which may be a fiscally unsound method of ensuring adequate clinical quality by registry staff. The Office of the Receiver also stated that it is in the process of hiring full-time permanent civil service clinical staff, and there will be, over time, an elimination or significant reduction in Corrections' reliance on registries.

Finding #11: Prisons did not always follow Corrections' procedures and contract terms for using registry contractors.

When prisons need to hire a service provider under a medical registry contract, Corrections requires them to follow the hierarchy outlined in the registries' contracts. For 22 of 38 invoices we reviewed that were subject to the hierarchy requirement, prisons did not provide us with sufficient documentation to demonstrate that they followed the hierarchy when obtaining services from registry contractors. When prisons do not consistently document their attempts to contact registry providers in accordance with the hierarchy, they expose the State to potential lawsuits from registry contractors for breach of contract terms and they hinder Corrections' ability to terminate registry contractors for nonperformance.

Also, we found that Corrections' policy allows prisons to send requests for services concurrently to all registries listed in the hierarchy. During our interviews with the 16 contractors in our sample, a few commented that, as a result of this practice, the providers do not respond to the contractors with the lowest bid but instead wait to be called by the contractors with the higher bids because they can receive more money.

We recommended that prison staff consistently follow procedures requiring them to document their efforts to obtain services from registry providers. We also recommended that Corrections reevaluate its policy of allowing prisons to send out service requests concurrently to all registry contractors listed in the hierarchy.

Corrections' Action: Pending.

According to the Office of the Receiver, it plans to take this recommendation into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008. Also, related to the recommendation that Corrections reevaluate its policy of allowing prisons to send out service requests concurrently to all registry contractors listed in the hierarchy, the Office of the Receiver stated that although services requests are solicited concurrently, the institutions are still required to follow the procedures developed to use the hierarchy. The Office of the Receiver also stated that it is in the process of modifying the hierarchy strategy, the number of registry contracts it has, and the actual reliance on the registry process.

Finding #12: Prisons sometimes fail to monitor invoices for medical services adequately.

Prisons could not provide sufficient evidence of their verifications that services were performed before they authorized payment for three of 50 invoices we reviewed. Prisons also did not always identify and adjust discrepancies between contract rates and providers' invoice charges resulting in overpayment of $4,050 for five invoices that totaled $458,346. In addition, prisons paid overtime on seven invoices even though contractors did not adhere to the contract provisions for overtime. Further, prisons and regional accounting offices failed to take available discounts or took the wrong discounts for the wrong amounts in 14 instances, and paid contractors late penalty payments in four instances because they failed to pay the invoices in compliance with the California Prompt Payment Act (CPPA).

We recommended that Corrections ensure that prisons verify the services they receive from registry contractors before authorizing payment of invoices and continue to implement the draft of a departmentwide policy reiterating the need for prison medical staff to adhere to proper procedures for verifying registry contractors' hours before authorizing payment.

We also recommended that Corrections ensure that prisons obtain the necessary documentation for the services they were unable to verify or seek reimbursement from the registry contractors for the overpayments identified in this report and establish a quality control process to ensure that prisons pay rates that are consistent with contract terms.

Further, we recommended Corrections ensure that prison staff responsible for authorizing overtime adhere to overtime policies and contract terms. Corrections should also evaluate its prisons and regional accounting offices' processes for paying invoices and identify weaknesses that prevent it from maximizing the discounts taken and complying with the CPPA.

Corrections' Action: Pending.

According to the Office of the Receiver, it plans to take the recommendations into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008. Also, related to our recommendation that Corrections evaluate its prisons and regional accounting offices' processes for paying invoices and identify weaknesses that prevent it from maximizing the discounts taken and complying with the CPPA, the Office of the Receiver stated it agrees with the recommendation. Specifically, its new contracting and invoice processing system that is currently being piloted at four prisons will be centralized at headquarters commencing on October 18, 2007, and will help to improve or standardize the payment timeframes and maximize discounts taken. The Office of the Receiver's goal is to implement this processing system statewide incrementally adding prisons to the pilot program in a three-phased approach, which it anticipates completing by 2009.

Finding #13: Corrections fails to demonstrate that it complies fully with certain political reform act requirements.

Corrections lacks adequate controls to ensure that it complies with the duties and responsibilities outlined in the political reform act for filing officers. Specifically, Corrections could not demonstrate that all employees and consultants required to file statements of economic interests and seek approval before engaging in outside employment did so. We reviewed 124 statements and found that seven employees did not complete their statements correctly and 78 filed their statements late. Also, we found that 14 employees did not file statements at all. Further, seven of nine prisons did not submit a copy of the statements for their health care consultants or the chief executive officer's written determination that their consultants were not required to comply with disclosure requirements.

We recommended that Corrections establish an effective process for tracking whether its designated employees, including consultants, have filed their statements of economic interests timely. We also recommended that Corrections review the statements of economic interests to ensure their accurate completion and to identify potential conflicts of interests. Further, we recommended that Corrections ensure that the chief executive officer retains his or her written determinations for consultants.

Corrections' Action: Pending.

The Office of the Receiver agrees with the recommendation to establish an effective process for tracking whether its designated employees, including consultants, have filed their statements of economic interests timely and to review the statements of economic interests to ensure their accurate completion and to identify potential conflicts of interests. It plans to develop and implement a process by March 2008 for tracking and reviewing statements of economic interests.

The Office of the Receiver does not agree that registry consultants should be interpreted as "consultants" for purposes of annual conflict-of-interest disclosure purposes and plans to obtain a legal opinion by December 2007 regarding which government decision makers shall be required to submit Form 700 as outlined in the Political Reform Act. The Office of the Receiver stated that it will provide a copy of the legal opinion to the bureau.

Finding #14: Corrections' credentialing unit often failed to verify properly the credentials of registry contractors' providers.

The credentialing unit does not verify the status of all providers who treat inmate patients. Specifically, the credentialing unit does not perform database searches for providers who treat inmate patients outside of Corrections' facilities. The credentialing unit also does not perform database searches of providers who it classifies as allied health professionals, such as pharmacists, registered nurses, laboratory technicians, radiological technicians, dietitians, and physical therapists.

In addition, Corrections does not have a departmentwide policy directing the prisons to verify the credentials of these providers, which creates confusion and the risk that providers will not undergo any credentialing before performing services. The credentialing unit also does not perform database searches on all physicians and nurse practitioners who provide services to inmate patients. The credentialing unit performs a search only after the prisons submit a request.

Finally, the credentialing unit's database search method is inefficient. Specifically, providers' credentials are verified each time they move to another prison. According to Corrections' former credentialing coordinator, who is now the manager of the Plata Support Division's Pre-Employment Clearance Unit, based on information provided by the U.S. Department of Health and Human Services, she believed that because each prison has its own formal peer review process to further quality health care, federal law requires Corrections to register them as separate eligible entities for purposes of querying the databases. She also stated that Corrections' management has not formally adopted a written policy regarding her interpretation of federal law. This current process appears unnecessary and a waste of time and money.

We recommended that Corrections require the credentialing unit to verify the credentials of contracted providers who work in non-Corrections' facilities or, at a minimum, verify that these facilities have a rigorous process for verifying the credentials of their providers. Corrections should also establish a policy to define allied health professionals and to identify professionals who will be credentialed by the credentialing unit versus those credentialed by the prisons. We also recommended that Corrections require the credentialing unit to determine whether the credentials of those medical and allied health providers who are performing services at prisons under registry contracts have been verified. If not, the credentialing unit should verify them. Further, we recommended that Corrections ensure that prisons request National Practitioners Data Bank searches from the credentialing unit before allowing providers to perform services. Finally, we recommended that Corrections seek clarification from the U.S. Department of Health and Human Services regarding the criteria for eligible entities and whether or not all prisons can be combined into one eligible entity.

Corrections' Action: Partial corrective action taken.

According to the Office of the Receiver, it agrees with the recommendations and on August 30, 2007, it disseminated a contract provider policy that outlines the policy and procedure regarding what is required to credential contract providers that provide on-site services.

Additionally, related to the recommendation to require the credentialing unit to verify the credentials of contracted providers who work in non-Corrections facilities or, at a minimum, verify that these facilities have a rigorous process for verifying the credentials of their providers, the Office of the Receiver stated that the credential unit is in the process of determining the feasibility and processes as to the credential verification of outside community independent providers. Specifically, the credential unit is in the initial phase of developing policy to address the process in which all independent contractors who provide services outside of Correction's prison facilities either be credentialed through the Correction's Credentialing and Privileging Unit, or at minimum the contractor must have verified staff privileges at a JACHO (Joint Commission on Accreditation of Healthcare Organizations) accredited community hospital. The Office of the Receiver anticipates implementing this policy and procedure in March 2008.

The Office of the Receiver further stated that it agreed with the recommendation to establish a policy to define allied health professionals and to identify professionals who will be credentialed by the credentialing unit versus those credentialed by the prisons. The Office of the Receiver stated that the problem will be procedurally addressed with the development and dissemination of an Allied Health Professional certification checklist and protocols in conjunction with the credential policy and with the inclusion of requirements for certification and professional credentialing verification in contract language. Further, the new contract provider policy instructs the Health Care Management and Institutional Personnel Officers that they shall not hire any licensed independent provider until a credential verification has been completed and approved by the headquarters' Credentialing and Privileging Unit. Finally, related to the recommendation that Corrections ensure that prisons request National Practitioners Data Bank searches from the credentialing unit before allowing providers to perform services, the Office of the Receiver stated that it will develop and establish a statewide medical staff and peer review structure. Once this structure is in place, the 33 National Practitioners Data Bank entities will be deactivated and all providers will be processed through the main National Practitioners Data Bank entity. The Office of the Receiver anticipates this structure will be implemented by February 2008.

Indian Gaming Special Distribution Fund

Local Governments Do Not Always Use It to Mitigate the Impacts of Casinos, and Its Viability Will Be Adversely Affected by Compact Amendments

REPORT NUMBER 2006-036, JULY 2007

California Gambling Control Commission's and Six County Indian Gaming Local Community Benefit Committees' responses as of September 2007

Government Code, Section 12717, requires the Bureau of State Audits (bureau) to conduct an audit every three years regarding the allocation and uses of moneys from the Indian Gaming Special Distribution Fund (distribution fund) by the recipients of the grant money and report its findings to the Legislature and all other appropriate entities. We evaluated the use and administration of distribution fund grants at six counties: Fresno, Placer, Riverside, San Bernardino, San Diego, and Sonoma.

We also compared fiscal year 2005–06 distribution fund contributions to estimated future contributions based on changes in compact provisions in new and amended pending compacts to determine the ability of the distribution fund to continue to fund the programs that depend on it. We then compared estimated contributions to current year expenditures from the distribution fund. Because we are unable to project how fast casinos will expand or forecast the changes to their profitability, we made a conservative estimate based on fiscal year 2005–06 gaming device counts and net win figures.

In his fiscal year 2007–08 veto message, the governor deleted the appropriation for grants to local government agencies to mitigate the impact of casinos. However, Assembly Bill 1389 (AB 1389) would appropriate $30 million from the distribution fund to provide grants to local jurisdictions subject to several provisions. Finally, several counties stated in their response that the recommendations addressed to their respective Local Community Benefit Committee (benefit committee) for improving the process would not be considered until funding is restored.

Audit Highlights . . .

Our review of the allocation and uses of the Indian Gaming Special Distribution Fund (distribution fund) money revealed the following:

- *Local governments did not always use distribution fund money to mitigate casino impacts.*
- *The allocation of distribution fund money in some counties is based, in part, on the number of devices operated by tribes that did not pay into the fund because their compacts require them to negotiate directly with the county to pay for the mitigation of casino impacts. However, these counties continue to receive distribution fund dollars from the State.*
- *In many instances local governments do not use interest earned on unspent distribution fund money for projects related to casino impacts.*
- *Although all benefit committee members are required to file statements of economic interests, in our sample counties, 11 of the 13 tribal members that were required to file failed to do so.*
- *The ratification of compacts in June 2007, along with one that is awaiting ratification, may threaten the future viability of the distribution fund and the programs that depend on it, as they eliminate $92 million in payments to the fund beginning in fiscal year 2007–08. While we estimate that contributions to the State's General Fund would also total at least $174 million, almost $40 million per year could be required to pay for the estimated shortfall in the Revenue Sharing Trust Fund.*

Finding #1: Local governments did not always use the distribution fund to pay for mitigation projects.

The legislation establishing the distribution fund declares the intent of the Legislature that tribal governments participate in identifying and funding mitigation of the impacts of tribal gaming through the grant process. The legislation also states that the grants are for distribution to local governments impacted by casinos. Finally, the senate floor analysis describes the legislation creating the distribution fund and grant process as establishing "priorities and procedures . . . for the purpose of mitigating impacts from tribal casinos." However, the legislation does not establish a clear requirement that the grants be used only for projects that actually mitigate the impacts from tribal casinos in all instances.

Based on our review of 30 grants, we determined that often a distribution fund grant financed a project that had the potential of offsetting the repercussions of a casino but was mainly used for activities that benefited the county as a whole. In 10 instances, the goods and services purchased with grant money had the potential for use in mitigating casinos' impact, should the need arise. However the main beneficiaries were the counties as a whole. Even though the potential exists that some of the goods or services acquired with these grant funds could be used to mitigate the impact of a casino, it is unclear whether the Legislature intended distribution fund grants to be used in this manner. In other cases grant funds were used for projects totally unrelated to casinos. Specifically, in five instances the money was not used to offset the adverse effects of casinos. Although these and other purchases may be beneficial to the counties, when a distribution fund grant is used for purposes that have little or no relationship to a casino impact, the problems the community experiences because of a casino may not be adequately addressed. The remaining 15 grants we reviewed were used specifically to alleviate casino impacts.

We recommended that the California Gambling Control Commission (gambling commission) seek legislative changes to amend the government code to provide direction to local governments to ensure that they use distribution fund grants only to purchase goods and services that directly mitigate the adverse impacts of casinos on local governments and their citizens.

We also recommended that benefit committees require local governments to submit supporting documentation that clearly demonstrates how proposed projects will mitigate the effects of casinos.

Gambling Commission's Action: None.

➲ The gambling commission states that because it does not have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which requires that benefit committees select only grant applications that directly mitigate impacts from casinos, and cause any grant for expenditures not related to Indian Gaming to terminate immediately and revert to the Individual Tribal Casino Account. Further, the bill requires that if an expenditure to mitigate the impact of a casino provides other benefits to the local jurisdiction, the grant may only finance the proportionate share of the expenditure that directly mitigates the impact from the casino. This bill was referred to the committee on governmental organization on December 13, 2007.

Fresno County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it is working with staff to codify more comprehensive descriptions and procedures for the management of funds, and their award and distribution. These procedures will be reviewed at a benefit committee meeting on November 30, 2007. However, the benefit committee also stated that it believes it is contradictory for the report to imply that some expenditures adhere to the explicit requirements of the law without meeting the intent of the law.

Placer County Indian Gaming Benefit Committee's Action: None.

➲ Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that the process in place requires applicants to describe the impact they propose to mitigate and how they will do so. However, the benefit committee indicated that during the next award cycle staff will review the descriptions in sponsored applications and provide an assessment on each application's apparent relevance to casino and gaming impacts.

San Bernardino County Indian Gaming Benefit Committee's Action: None.

The benefit committee states that it will continue to use its current application process, which includes a requirement that the applicant provide a detailed project description and information that demonstrates how the project will mitigate the effects of casinos; a procedure which does not differ from that in practice when the grants we reviewed were approved.

San Diego County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that in the next cycle of grants the application form will be amended to add a requirement that if only a small part of the project proposes to mitigate impacts related to casinos, funding for the portion of the project that provides benefits unrelated to impacts from casinos be funded from another source. However, while the benefit committee also plans to remind applicants to describe the impact on their jurisdiction and explain how their project will mitigate those impacts, this procedure does not differ materially from that in practice when the grants we reviewed were approved.

Sonoma County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it has adopted an application form that requires grant applicants to provide a complete project description, describe the impacts on their jurisdiction associated with the casino and include any data supporting the request for funds, and explain how the project will mitigate these impacts.

Finding #2: Compacts ratified since 1999 require tribes to directly fund efforts to mitigate casinos' impacts, but local governments continue to receive distribution fund money.

Post-1999 compacts require tribes to negotiate directly with local governments to pay for local mitigation projects in lieu of paying into the distribution fund. However, based on the allocation methodology established in state law in 2004, two counties where casinos under post-1999 compacts are located received roughly $850,000 in distribution fund money in fiscal year 2005–06. Local governments in those counties received money for projects that, in accordance with the post-1999 compacts, should have been funded directly by the tribes. Consequently, less distribution fund grant money is available to other counties where tribes are not required to provide funding directly to local governments.

We recommended that the gambling commission seek changes to legislation to revise the allocation methodology outlined in the government code so that the allocation to counties is based only on the number of devices operated by tribes that do not negotiate directly with local governments to mitigate casino impacts.

Gambling Commission's Action: None.

The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Finding #3: Interest that local governments earned on unspent distribution fund money has not always gone toward mitigation projects.

Some local governments have earned interest on distribution funds until the funds are needed for an intended project. In many instances, large amounts of grant money remained unspent for more than a year, and the local governments indicated to us that the interest earned was not always allocated back to the original project or used for similar future projects. In fact, several local governments we spoke to used the interest to pay for general county operational costs. In some cases local governments did not even earn interest, instead depositing the grant funds in accounts that generate no interest.

Our legal counsel advised us that although the law does not specifically require a local government to allocate interest earned on unspent funds to original or future mitigation projects, the government code section cited by local governments states that earned interest may be deposited in their general funds unless otherwise specified by law. The purposes for which distribution fund money may be spent are set forth in the compacts and state law. Accordingly, our counsel advised us that the interest on distribution fund money is subject to the common law rule that unless it is separated by statute from the principal, the interest should be used for the originally intended purpose. Thus, we believe the interest should be used to support mitigation projects. However, several local governments asserted that the government code grants them authority to use interest earned for general purposes. Further, local officials indicated that a significant number of grants were maintained in accounts that earned no interest. Because the interest on distribution fund money is subject to the common law rule that unless it is separated by statute from the principal, the interest should be used for the originally intended purpose, we believe the interest should be used to support mitigation projects.

We recommended that the gambling commission seek changes to legislation to amend the government code to require that all funds be deposited into interest-bearing accounts, and that any interest earned is used on projects to mitigate casino impacts.

Further, we recommended that benefit committees ensure that local governments spend the interest earned on project funds only on the projects for which the grants were awarded or return the money to the county for allocation to future mitigation projects.

Gambling Commission's Action: None.

➲ The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which requires any jurisdiction that receives a grant from an individual tribal casino account to deposit all funds received in an interest bearing account and use the interest from those funds only for the purpose of directly mitigating an impact from a casino. This bill was referred to the committee on governmental organization on December 13, 2007.

Placer County Indian Gaming Benefit Committee's Action: None.

➲ Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee stated that it has sent letters to all mitigation grant recipients clarifying the need to maintain mitigation grant funds in interest bearing accounts and the required use of interest earned for casino/gaming mitigation measures.

San Bernardino County Indian Gaming Benefit Committee's Action: Corrective action taken.

The county stated that it has changed its contract language to ensure that interest earned on distribution funds for long-term capital projects will remain with the project. Material amounts of grant money for long-term projects that remain unspent will be required to be deposited into an interest bearing account. All interest earned will be allocated back to the original projects or used for future mitigation projects.

San Diego County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it will instruct applicants to either spend the interest earned on projects that mitigate impacts or return the interest to the benefit committee for allocation to future mitigation projects, if state law allows it to do so. However, the benefit committee also states that it disagrees with the bureau's interpretation of state law and that another section of the government code requires it to separate the interest from the principal and deposit it in the benefit committee's general fund.

Sonoma County Indian Gaming Benefit Committee's Action: None.

The benefit committee states that it disagrees with the recommendation and that absent changes to state law, will not change its procedures.

Finding #4: Grant allocations have generally been properly calculated, but some local governments were not awarded the amounts they were allocated through the Nexus test.

State law requires a county receiving distribution fund money to allocate a portion of its funding to local governments based on the Nexus test criteria described in the text box. In Riverside County, we identified two instances where the Nexus test criteria were not consistently applied. County officials agreed with our assessment and stated that the county would revise its application of the Nexus criteria. Further, Riverside County did not even adhere to its inaccurate Nexus test calculation. We identified several instances where cities in Riverside County were awarded less money than they should have been allocated under the Nexus test.

We recommended that benefit committees correct the inconsistent application of Nexus test criteria and ensure that local governments receive at least the minimum amounts they are allocated under the government code requirements.

Nexus Test Criteria

1. The local government jurisdiction borders Indian lands on all sides.
2. The local government partially borders Indian land.
3. The local government maintains the highway, road, or predominant access route to a casino within four miles.
4. All or a portion of the local government is located within four miles of a casino.

Riverside County Indian Gaming Benefit Committee's Action: None.

The benefit committee stated that the county has updated its information identifying how many Nexus test criteria local governments meet in order to determine what percentage share of the Nexus grant funds they are eligible to receive. However, statements in the benefit committee's response indicate that it is confused regarding the application of the formula to these corrected criteria. The committee seems to hold the mistaken impression that each local government receives a percentage of the money, rather than, as described in law and our report, each local government is entitled to an equal share of the percentage allotted to local governments meeting the same number of criteria.

Finding #5: Some grantees were not eligible for funding.

Although state law defines the intended recipients of distribution fund money—cities, counties, and special districts—some benefit committees provided grant money to ineligible entities. In two cases benefit committees awarded grants to school districts, which state law specifically excludes from the definition of special districts. Because the Legislature has identified specific entities and purposes for distribution fund grant money, counties must ensure that they follow the statutory requirements.

We recommended that benefit committees grant distribution fund money only to eligible entities.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which—for the purposes of this program—excludes school districts from the definition of "special district." This bill was referred to the committee on governmental organization on December 13, 2007.

Fresno County Indian Gaming Benefit Committee's Action: Pending.

The Fresno County Indian Gaming Local Community Benefit Committee (Fresno) states that it is working with staff to codify more comprehensive descriptions and procedures for the management of funds, and their award and distribution. These procedures were scheduled to be reviewed at a meeting on November 30, 2007.

Riverside County Indian Gaming Benefit Committee's Action: None.

The benefit committee did not address our recommendation.

Finding #6: Some benefit committee members fail to meet disclosure requirements.

The Political Reform Act of 1974 (political reform act) requires state and local officials and employees with decision-making authority to file statements of economic interests annually and on assuming or leaving a designated position. These statements are intended to identify conflicts of interest that an individual might have. However, the counties we visited could not provide 11 of the 13 statements of economic interests for tribal representatives on the benefit committees for fiscal year 2005–06.

Three of the six counties we visited informed us that the tribal members of their respective benefit committees asserted that they are exempt from the requirements to submit statements. However, the California Fair Political Practices Commission has issued an advice letter regarding this issue stating that any individual serving in a capacity as a member of a public agency, including tribal members of benefit committees, are subject to the provisions of the political reform act. The remaining three counties indicated that they do not know the reasons tribal members did not file the required statements. When designated individuals do not file statements of economic interests, benefit committees may be unaware of conflicts of interest. Further, the benefit committees cannot ensure that members are aware that they should remove themselves from making decisions that may pose conflicts of interest.

We recommend that benefit committees ensure that all benefit committee members follow the political reform act and file the required statements of economic interests, and inform the appropriate agency if they fail to do so.

Fresno County Indian Gaming Benefit Committee's Action: None.

The Fresno County Indian Gaming Local Community Benefit Committee (Fresno) states that in spite of the California Fair Political Practices Commission's advice letter, it is the position of the benefit committee that as members of a sovereign nation, tribal members are exempt from the requirement.

Placer County Indian Gaming Benefit Committee's Action: None.

Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that the county is working with tribal members and anticipates resolution of this issue by October 31, 2007.

San Bernardino County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will continue to inform members of the requirement to file their statements at intervals before and after the deadline, and will notify the appropriate state agency if they do not file within two weeks of the deadline.

San Diego County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that they will remind benefit committee members to submit required statements and will inform the State of any failure by a benefit committee member to do so.

Sonoma County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee indicates that they will continue to ask all members to submit required statements of economic interests and will inform the appropriate state agency if they fail to do so.

Finding #7: Many counties did not properly report their use of distribution fund money.

State law requires each county that receives distribution fund grants to submit an annual report by October 1 each year detailing, among other information, the specific projects funded by the grants and how current-year grant money has been or will be spent. Nevertheless, many counties fail to submit the reports to all required entities. In fact, according to the gambling commission and various legislative committees, in 2006 only nine counties reported to all required entities, which include the gambling commission, the chairs of the Senate and Assembly committees on governmental organization, and the chair of the Joint Legislative Budget Committee. Furthermore, six of the 24 counties receiving funds did not report at all.

We recommended that the gambling commission seek changes to legislation to amend the government code to allocate distribution fund money only to counties that submit annual reports as required.

Further, we recommended that benefit committees submit complete annual reports to all required legislative committees and the gambling commission.

Gambling Commission's Action: None.

The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which designates any county that does not provide an annual report pursuant to the government code requirements as ineligible for funding from the distribution fund for the following year. This bill was referred to the committee on governmental organization on December 13, 2007.

Placer County Indian Gaming Benefit Committee's Action: None.

Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will provide information for grants funded in the current fiscal year in its next annual report.

Sonoma County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will submit annual reports to all required legislative committees and the gambling commission by the deadline specified in state statute.

Finding #8: New compact provisions will change the amount of revenues in the distribution and trust funds.

In June 2007 the Legislature ratified one new compact and four of five amendments to existing compacts—the fifth compact amendment was ratified after our audit. From a review of current operating information and compact terms, we estimated that the one new compact and five amendments (pending compacts) to existing compacts would significantly decrease revenues in the distribution fund and, to a lesser extent, increase Revenue Sharing Trust Fund (trust fund) revenues. We conservatively estimated that annual contributions to the trust fund from these compacts would increase by about $6.9 million, while annual contributions to the distribution fund would decrease by $92 million. If the revenue and expenditure levels estimated for fiscal year 2007–08 continue into the future, without additional resources the distribution fund will be unable to meet its obligations by fiscal year 2010–11, approximately four years from now. In addition to the impact on the distribution and trust funds, we estimated that contributions to the State's General Fund from these compacts would total between $174.3 million and $175.1 million for fiscal year 2007–08. Further, as casino operations expand, General Fund revenues will increase.

Finding #9: Post-1999 and pending compacts and amendments provide revenues to the General Fund.

Between 2003 and 2006, the Legislature ratified five new compacts and amendments to eight others (post-1999 compacts), which provided $128 million in General Fund revenue in fiscal year 2005–06. However, that figure will increase because several casinos operating under post-1999 compacts only recently began operations or will begin operations this year. Overall, we estimated that General Fund revenues for fiscal year 2007–08 from the post-1999 and pending compacts discussed above will total between $304 million and $313.5 million. These amounts represent between 4.3 percent and 4.5 percent of the $7 billion in revenue that Indian gaming in California generated during fiscal year 2004–05. Further, for fiscal year 2007–08, we estimated that trust fund and distribution fund revenue from tribal contributions will total $39.4 million and $47 million, respectively, representing 0.6 percent and 0.7 percent of total fiscal year 2004–05 gambling revenue, respectively.

Finding #10: General Fund revenues may be used for many purposes.

Future General Fund revenue contributions from Indian gaming may be used to help reduce the impact of the $92 million decrease in distribution fund revenue. However, without further clarification in the government code by the Legislature, it is unclear if compact provisions that redirect a portion of their General Fund revenue contributions to the trust fund if there is an insufficient amount in the trust fund to distribute $1.1 million to each eligible tribe take place before or after the government code requirement for the distribution fund to cover any such shortfalls in the trust fund. Furthermore, the General Fund contributions required by the compacts may also be obligated to repay a California Department of Transportation fund that made loans to the General Fund in prior fiscal years. As such, any increase in General Fund revenue from pending compacts may be obligated to repay the Transportation Congestion Relief Fund and thus would not be available for backfill distributions required by the trust fund or for other purposes.

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

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 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.

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.***
- ***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.***

continued on next page . . .

» *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.*

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.

Department of Forestry and Fire Protection

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

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

Department of Forestry and Fire Protection's response as of February 2007

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.

Forestry's Action: Partial corrective action taken.

Forestry reported that, for the air operations officers acting as pilots, it has actively started to process the overpayments as receivables. It also reported that it has taken steps to inform supervisors and managers of any significant changes to union agreements that would impact rank and file salary, benefits, or classification status.

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: Partial corrective action taken.

Forestry agreed that the heavy equipment operator was overpaid and it has started to process a receivable for repayment. Further, Forestry is evaluating adverse action for this employee.

Department of Corrections and Rehabilitation

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

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

Department of Corrections and Rehabilitation's response as of March 2007

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).

Investigative Highlights . . .

The 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.*

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.

Two of the nine exempt employees we reported on are no longer working at the center. We conducted additional analysis on the remaining seven employees for the time period from June 2005 to December 2006. We determined that exempt employees continued to earn holiday credits when a holiday fell on their regularly scheduled day off, resulting in an additional accrual of 268 hours and an additional gift of public funds of $8,909 for seven employees.

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, between July 2002 and May 2005 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: Partial corrective action taken.

We conducted additional analysis on seven employees at the center for the time period from June 2005 to December 2006. The center continues to allow the employees to work alternate work schedules consisting of 10-hour days, but still requires them to charge leave only in eight-hour, six-hour, and four-hour increments, for employees working full-time, three-quarter time, and half-time schedules. As a result of this practice, the State paid these employees $21,161 for 620 hours they did not work.

In January 2007 the State and the union representing the employees in this case adopted a new collective bargaining agreement. This agreement specifies that exempt employees shall not be charged leave in less than whole-day increments.

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 February 2007

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).

Investigative Highlight . . .

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

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: Corrective action taken.

The Board reported that it believes it had jurisdiction to hear the physician's claims and stated it did so under state law that allows the Board to hear claims when no statute or constitutional provision provides for the 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 the statutory relief was available in this case.

The Board also reported that it has changed its procedures to avoid making overpayments in the future. Specifically, the Board reported that it will not assume authority over claims in those instances in which it is aware that another agency is addressing the claim. Additionally, the Board reported that it changed its payment process for approved claims to ensure affected state agencies are aware of its actions.

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 April 2006 Corrections reported it had recovered ➲ $2,000 from the physician. However, it has been unable to confirm any additional amount the physician has reimbursed the State.

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 2007

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.

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.***

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: Partial corrective action taken.

Fish and Game reported that in August 2006 it began the process of adjusting rental rates to fair market values in accordance with DPA regulations and applicable collective bargaining agreements and began raising rental rates in October 2006. Fish and Game also reported that it last obtained appraisals approximately 14 years ago and in order for it to report accurate taxable fringe benefit information, it must first obtain current fair market appraisals for its properties. Fish and Game added that it has identified funding to obtain fair market appraisals and will do so after DPA establishes the master agreement for appraisers.

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.[2]

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.

2 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. Parks and Recreation has not reported any updated information since March 2006.

Department of Corrections and Rehabilitation's Action: Pending.

The Department of Corrections and Rehabilitation (Corrections), including the Division of Juvenile Justice, reported that DPA is anticipating awarding a contract for state-owned housing appraisal services that can be used by all state agencies. Corrections stated that it intends to obtain fair market appraisals for its properties through the contract, which is expected to be awarded by April 2007.

Department of Developmental Services' Action: Pending.

The Department of Developmental Services (Developmental Services) reported that it will obtain fair market appraisals once DPA establishes a master agreement of licensed appraisers and has authorized departments to begin contracting for appraisals. Developmental Services also reported that it has evaluated its systems and processes for reporting fringe benefits to ensure it will be in compliance with reporting guidelines once it is able to establish and update its rental rates.

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. Forestry has not reported any updated information since March 2006.

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

The Department of Mental Health reported that it updated its special order addressing employee housing in December 2006. This special order requires all four of its hospitals to perform appraisals of fair market rental rates for their properties by March 2007 and to reassess those rates annually. In addition, the special order requires its hospitals to report accurate taxable fringe benefit information in a timely manner.

Department of Transportation's Action: Corrective action taken.

The Department of Transportation (Caltrans) reported that it performed additional analysis to determine what amount of taxable fringe benefits it should have reported for 2003. It determined that the net total of additional income that should have been reported was $1,232 for six of its employees residing in state homes. Caltrans added that as of April 2006, this amount was reported to the tax authorities.

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 reported that it has adjusted rental rates for its properties 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.

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. Conservation has not reported any updated information since March 2006.

Department of Personnel Administration's Action: Pending.

The Department of Personnel Administration (DPA) reported that it became aware that some departments, which attempted to contract for appraisal services, received bids that were too costly and not in the best interest of the State. As a result, in February 2007 DPA issued a request for proposal in an effort to solicit bids for a statewide master agreement of licensed appraisers. DPA expects to finalize agreements in June 2007 with the seven appraisal firms awarded contracts.

Department of Industrial Relations

Its Division of Apprenticeship Standards Inadequately Oversees Apprenticeship Programs

REPORT NUMBER 2005-108, SEPTEMBER 2006

Labor and Workforce Development Agency's response as of August 2007

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:

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.***
- ***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.***

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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 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.

[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.

» *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.*

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 on the first recommendation; no action taken on the second recommendation.

The division stated that it filled its consultant and field support vacancies and that for fiscal year 2007–08 it received a staffing augmentation of four new consultants who will specifically focus on audits. It also indicated that by late August 2007 it had completed 13 audits and had six more audits in process or scheduled to begin by the end of September 2007. The division says it is proceeding with audits as currently required by statute and regulations, and has not developed revised legislation 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 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: Corrective action taken on the first and second recommendations; no corrective action taken on the third recommendation.

The division said that complaints have been assigned to one individual at its headquarters, 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 agency indicates that the complaints backlog has been mostly cleared with only 10 pre-2007 complaints still open, all in the hearing phase.

The division says that the U.S. Department of Labor does not recognize California's authority to approve apprenticeship programs for federal purposes in March 2007. As such, it has suspended federally required Cal Plan audits. Instead, the division has implemented reviews of programs' selection procedures during regular visits and during audits of programs. These reviews have led to the revision of several program standards in order to bring the standards into sync with the actual practice of the programs. 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, it has developed performance measurements for the standards and has set priorities related to oversight activities. The division also indicated that compliance with annual self-assessment reviews is very high and that staff are now working with programs to improve the quality of the self-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: Corrective action taken on the first and second recommendations; no corrective action taken on the third recommendation.

The division stated that the Legislature has received reports for 2003 through 2006. In addition, it says it has created an annual calendar that includes a task for submitting the report by April 1st of each year.

The division said that $1.2 million in grants for fiscal year 2006–07 were distributed in December 2006. Further it stated that the fiscal year 2007–08 budget includes an increase in the distribution authority to $3 million, which should be distributed by mid-September 2007. 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 the 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: Partial corrective action taken.

The division stated that consultants have been aggressively working with programs to synchronize program and division records. It also says that its roll-out of the electronic transmission of apprentice registration and drop forms has been moving more slowly than planned, but about 30 percent of apprentices are now being reported electronically. The division did not mention any effort it had made to use data to set performance goals or to pinpoint program successes or failures.

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

California Department of Health Services', the Governor's Office of Emergency Services', and the Governor's Office of Homeland Security's responses as of September 2007

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).

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.***

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.

According to Emergency Services, it is putting together a statewide exercise strategy that would include currently scheduled exercise programs such as Golden Guardian and Statewide Medical and Health. It stated that the strategy will also include any exercise needs identified as a result of a training needs assessment and as training needs are met, that training will be tested as part of an exercise. Emergency Services also told us that it had released a draft of the exercise strategy to its partnering local and state agencies and is collecting their changes and additions for inclusion in the document. It believes it will implement the program in December 2007.

Emergency Services did not address that portion of the recommendation related to ensuring that future exercises are as realistic as possible.

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

State Homeland Security did not address this recommendation in its one-year response to our audit. However, in its earlier responses, 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 State Homeland Security continue to work cooperatively and are committed to reducing the processing time for all reimbursement claims. It also stated that the two offices currently process claims in an average of 35 days from receipt and the goal is to reduce the time to the 30 days mentioned in state law. According to Emergency Services, it expects to reach the 30-day goal by September 30, 2007.

State Homeland Security's Action: Corrective action taken.

According to State Homeland Security, it will continue to create many forums for local first responders and administrators to share best practices and concerns. It cited its Program and Capability Review (review) as one example of such a forum. State Homeland Security stated that as part of this review, local agencies participated collaboratively with it in the grant application process and identified needs for local, regional, and statewide preparedness. It also stated that the review allowed local agencies to discuss grant issues with colleagues from around the State. State Homeland Security also mentioned it hosted two statewide conferences, which included panel discussions concerning grant monitoring and audit requirements.

Regarding a collaboration to reduce the amount of time necessary to reimburse local jurisdictions, State Homeland Security stated that it and Emergency Services established timelines for processing and approving local reimbursement requests. State Homeland Security also stated that it has reduced the average time for its payment approval and transmittal to Emergency Services to 10 days or less, with the vast majority of claims being processed in four days or less.

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: Corrective action taken.

According to Emergency Services, it established a password-protected database designed to track its own plans and planning-related documents and those of other state and local agencies. It stated that the attributes tracked on this database include the adoption dates of the plans, the dates of required or advised updates, and the status of plans under development or review. Emergency Services also stated that it has assigned staff to oversee the database and to monitor the development and updating of emergency plans. Finally, it stated that it is working with state agencies and operational areas to enter planning information into the database and that the database was operational as of September 2007.

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. (NOTE: Effective July 1, 2007, the newly created Department of Public Health (Public Health) took over specified responsibilities from the Department of Health Services. Further, the State renamed the Department of Health Services as the Department of Health Care Services (Health Care Services). Although the responsibility for public health emergency preparedness now rests with Public Health, information we received indicates that the responsibility for reviewing cost reports resides with Health Care Services.)

Public Health's and Health Care Services' Actions: Corrective action taken.

According to Public Health, Health Care Services developed the audit protocols and audit programs for auditing subrecipients of federal bioterrorism preparedness funds. Public Health also stated that Health Care Services began audits of local health departments in February 2007. Finally, Public Health indicated that although Health Care Services was using existing staff to perform the audits, Health Care Services was recruiting to fill three full-time audit positions authorized by the budget for fiscal year 2007–08.

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, we recommended the following steps be taken:

- The governor and the Legislature consider streamlining the preparedness structure. For instance, they could consider establishing one state entity to be responsible for emergency preparedness, including preparedness for emergencies caused by terrorist acts.
- The Legislature consider statutorily defining the preparedness structure in law.
- The Legislature 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 could consider statutorily defining the relationship between State Homeland Security and Emergency Services.

Legislative Action: Legislation proposed.

According to Emergency Services, Assembly Bill 38 (AB 38) is the administration-sponsored bill to clarify organizational responsibilities for all-hazards disaster preparedness. Enacting AB 38 would create the Department of Emergency Services and Homeland Security. This new department would be vested with the duties, powers, purposes, responsibilities, and jurisdiction of the current Office of Emergency Services and the current Office of Homeland Security. The Assembly passed this bill in May 2007. As of December 2007, AB 38 is pending in the Senate.

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

REPORT NUMBER 2005-132, SEPTEMBER 2006

Los Angeles Unified School District's response as of October 2007

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 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.

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.*
- *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.*

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» ***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.***

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: Partial corrective action taken.

LAUSD previously indicated that its ability to more closely monitor organizational staffing changes would be greatly enhanced with the implementation of a new enterprise resource planning system called Business Tools for Schools. This system was to be implemented in three phases starting in July 2006. LAUSD states that implementation of the first phase had few problems, but that the second phase, which included human resources functions, has suffered many challenges after it was rolled out in January 2007. These challenges included payroll errors ranging from employees receiving no pay to receiving large overpayments. As a result, LAUSD decided to delay implementing the third phase until it resolves these problems.

LAUSD reports taking other steps to improve its ability to track the impact of organizational changes on its operations. In February 2007 the school board adopted a resolution requiring each division to use program effectiveness data to make decisions on resources allocations for the 2007–08 school year. Further, starting with the 2008–09 school year, LAUSD began preparing the budget earlier so that it could use data demonstrating program effectiveness in its budget decisions. Finally, LAUSD indicates the school board adopted a resolution in July 2007 requiring LAUSD to deliver a performance measurement plan to the board in late 2007. This plan is to provide measures to determine program and system effectiveness in both instructional and non-instructional areas. LAUSD reports creating a new division that will be responsible for establishing a system-wide performance measurement and accountability system.

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 that beginning in fiscal year 2006–07 it developed performance objectives 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 (advisory councils) are not serving the purpose that the 2000 reorganization plan intended.

The 2000 reorganization plan created 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 it has decided to continue using advisory councils. It is reviewing and developing, as needed, additional guidance on the composition and purpose of the councils and the local districts' role in assisting and monitoring the 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 developing draft performance objectives and measures aligned with its mission and the superintendent's goals for eight central office senior instructional managers and senior-level instructional positions at each of the local districts. In addition, LAUSD indicates that in January 2007 it began placing interim performance measures into each senior management contract submitted to the school board for ratification. As part of the process to establish a performance measurement system, LAUSD anticipates that job descriptions with measurable goals for these positions will be implemented in the 2008–09 school year and that the district's evaluation process will be updated during the 2009–10 school year.

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: Corrective action taken.

As part of an overall plan to standardize and consolidate the salary assignment process, LAUSD indicates that the Superintendent's Compensation Advisory Council, which began meeting in March 2007, now reviews salary-setting decisions for both classified and certificated positions to make recommendations to the superintendent and the Personnel Commission. It notes that all reports presented to the council and the Personnel Commission use a standard format. Also, LAUSD indicates that the Personnel Commission has updated its guidelines for conducting salary surveys, including augmenting the criteria used for salary recommendations and documenting its methodology.

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: Corrective action taken.

LAUSD indicates that it has implemented procedures 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 previously noted in findings 4, 5, and 6.

California Children and Families Commission

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

REPORT NUMBER 2006-114, OCTOBER 2006

California Children and Families Commission's response as of October 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.

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.***

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: Corrective action taken.

The state commission stated in its 90-day response to our audit that 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. In its one-year response, the state commission provided a schedule of the training courses that its staff attended between December 2006 and September 2007. It also stated that now that it has completed the Procurement Policy and Procedure Manual (manual), key staff will attend formal, internal training courses during November and December 2007 on topics such as contract concepts and timeline development, contract monitoring, invoice review and approval, and conducting and documenting solicitations. In its 90-day response, the state commission also had indicated that it appointed a specific staff member to track the training status of staff with contract responsibility. Finally, in its one-year response, the state commission pointed to a specific section of the new manual that discusses procedures its staff should follow when contractors do not appear to be complying with contract terms.

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: Corrective action taken.

Again, the state commission referred to its 90-day response, which stated that it was sending all staff with any contract management responsibility to various training courses. In that same response, it also indicated that it had developed standard language for all new contracts, which addresses allowable out-of-pocket expenses and 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 stated that it redesigned the work plans it requires its public relations contractors to provide to include a detailed description of services and to identify the deliverables, target audience, and proposed completion timeline, as well as other information. Finally, in its one-year response, the state commission pointed to various sections of its new manual that describes the processes and procedures staff must follow related to the scope of work for a contract, schedules for progress and completion of work, contract budgets, and work plans.

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: Corrective action taken.

The state commission's 90-day response indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend various training courses. Moreover, in its one-year response, it also pointed out a section in its new manual, which clearly indicates that the state commission must approve in advance final written subcontracts and conflict-of-interest certificates before the subcontractor performs any work. Further, in its 90-day response, the state commission indicated that it uses a Department of General Services' (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: Corrective action taken.

The state commission's 90-day response indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses. In its one-year response, it also referred to a section in its new manual that discusses its invoice review and approval process, including a process for comparing the invoice to various documents, such as the contract and work plans, before approving them for payment.

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's 90-day response, 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. Finally, in its one-year response, it pointed to the section of its new manual that prohibits advance payments unless specifically authorized by statute.

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.

In its 90-day response, the state commission indicated that the commissioners reviewed and approved the strategic plan in October 2006, which was effective until June 30, 2007. Additionally, in its one-year response, the state commission stated that it had developed and the commissioners adopted the most recent plan in September 2007.

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: Corrective action taken.

The state commission's 90-day response indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses. The state commission also referred to several sections of its new manual—acquisition planning, ensuring a full and open competitive process for formal competitive procurements, noncompetitively bid contracts, and competitive contracts receiving less than three bids, as well as others—where it has addressed some of the issues related to these recommendations. For example, the manual specifically identifies the documentation that staff must prepare when three bids are not received. It also provides guidance to staff related to noncompetitively bid contracts and justification as to the reasonableness of the contract costs.

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: Corrective action taken.

The state commission's 90-day response indicated that it is ensuring all staff with any contract management responsibility understand contracting procedures by requiring them to attend training courses. In its one-year response, the state commission also referred to several sections of it new manual that outline its competitive bid process including requirements that all RFPs include the evaluation criteria and selection process and all evaluation and scoring sheets be available for public inspection at the conclusion of the scoring process.

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: Corrective action taken.

The state commission indicated that its new manual addresses this recommendation. Our review of the new manual found that it provides guidance related to interagency agreements and contracts with governmental agencies, but more specifically, it states that work performed under a government contract generally must be performed by the contractor agency, not subcontractors. However, it also provides staff the specific provisions that apply if subcontractors are used under these types of contracts.

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: Corrective action taken.

The state commission indicated that its new manual addresses this recommendation. Our review of the new manual found that it contains a section that appears to provide appropriate guidance to staff on overhead fees and indirect costs, including establishing limits.

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: Corrective action taken.

Although in its 90-day response the state commission indicated that it had suspended its MOU program pending further review, its new manual provides specific guidance as to those few instances when an MOU can be used.

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 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: Corrective action taken.

The state commission's 90-day response stated that it is ensuring all staff with any contract management responsibility attend training courses related to contracting procedures. In its one-year response, it also referred to several sections in its new manual, one of which clearly states that staff are not authorized to instruct contractors to begin work before a signed copy of the contract is received.

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: Corrective action taken.

The state commission has hired a chief counsel. In its one-year response, the state commission did not address whether the chief counsel had reviewed the bureau's recommendation and advised commission staff regarding the legality of delegating the authority for taking certain actions regarding contracts. However, in a separate letter dated December 5, 2007, the state commission indicated that its chief counsel reviewed this issue beginning in May 2007 and continuing through July 2007, when she rendered her legal opinion to the commission and its staff. However, when we requested a copy of the legal opinion, the chief counsel told us that it was an oral opinion and that she could not provide us any information related to her opinion, asserting attorney-client privilege.

She did, however, provide us with the state commission's current policy related to the approval of contracts and it remains as it was during our audit. Accordingly, it is the continued practice of the state commission to authorize all expenditures in excess of $150,000, and to delegate to the executive director and his or her designee the authority to award and enter into any contracts that expend those funds.

Medical Board of California

It Needs to Consider Cutting Its Fees or Issuing a Refund to Reduce the Fund Balance of Its Contingent Fund

REPORT NUMBER 2007-038, OCTOBER 2007

Medical Board of California's response as of January 2008

Section 2435 of the Business and Professions Code (code) directs the Bureau of State Audits (bureau) to review the Medical Board of California's (medical board) financial status and its projections related to expenses, revenues, and reserves, and to determine the amount of refunds or licensure fee adjustments needed to maintain the reserve legally mandated for the medical board's contingent fund.

The medical board assesses fees for physicians and surgeons (physicians) according to rates and processes established in the code. In 2005, passage of Senate Bill 231 increased physicians' license fees (fees) from a maximum rate of $600 to $790. In addition to establishing the rate, the code also states that the Legislature expects the medical board to maintain a reserve, or fund balance, in its contingent fund equal to approximately two months of operating expenditures.

Audit Highlights . . .

Our review of the Medical Board of California's (medical board) financial status and fund balance revealed that:

- *The fund balance of the medical board's contingent fund increased by $6.3 million, to $18.5 million, in fiscal year 2006–07. This represented 4.3 months of reserves, more than 100 percent above the reserve level mandated in the law.*
- *The recent increase in the fund balance resulted from variances between actual and estimated expenditures.*
- *The medical board estimates that its months of reserves will drop to 1.5 months by June 30, 2012, assuming that it spends all of its appropriations in each of the next five fiscal years.*
- *However, based on the medical board's historical experience of overestimating expenditures, we estimate that it will have 3.8 months of reserves by June 30, 2012, unless it issues refunds or decreases license fees for physicians.*

Finding #1: The medical board does not have the flexibility to adjust fees because they are established in law.

The code requires the medical board to maintain a fund balance that would cover approximately two months of operating expenditures. The code also suggests that if the fund balance becomes excessive, the medical board should take action to reduce the fund balance. However, the code does not provide the medical board the flexibility to adjust fees.

We recommended that the medical board seek a legislative amendment to Section 2435 of the code to include language that allows it the flexibility to adjust physicians' license fees when necessary to maintain its fund balance at or near the mandated level.

Medical Board's Action: Partial corrective action taken.

The medical board said that it approved a motion in November 2007 to seek legislation to allow flexibility in the initial licensing and renewal fees. In January 2008 Assembly Bill 547 was amended to include language giving the medical board the flexibility to set these fees up to a maximum of $790 and, as of January 2008, was still in committee.

Finding #2: The fund balance of the medical board's contingent fund increased significantly in fiscal year 2006–07, resulting in reserves well above mandated levels.

The medical board's fund balance increased by $6.3 million to $18.5 million in fiscal year 2006–07, resulting in an increase in months of reserves to 4.3 months. The increase was caused mostly by the variance between estimated and actual expenditures in fiscal year 2006–07, primarily related to a planned expansion of medical board programs that was not fully realized in that year.

We believe the fund balance is unlikely to return to the level legally mandated unless fees are reduced or refunded. In particular, while the medical board's estimated revenues consistently approximated actual revenues in the last four fiscal years, the medical board has consistently overestimated expenditures by at least $2 million each year over the same period. Based on the medical board's future revenue and expenditure estimates, adjusted downward by $2 million for the expenditure difference just described, we estimate that the medical board still would have 3.8 months of reserves on June 30, 2012.

We recommended that the medical board consider refunding physicians' license fees or, if successful in gaining the flexibility to adjust its fees through an amendment to existing law, consider temporarily reducing them to ensure that its fund balance does not continue to significantly exceed the level established in law.

Medical Board's Action: Pending.

The medical board said it considered reducing or refunding license fees but instead initiated several other actions that it stated would bring its fund balance into line with mandated levels. These are:

- Seek legislation to increase the mandated two-month reserve to four or six months.
- Seek budget authority to reestablish the Operation Safe Medicine Unit, to expand the Probation Program, and to replace its information technology infrastructure.
- Transfer $500,000 to the Health Profession Education Foundation to assist with the funding of a loan repayment program.

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

Department of Education's response as of March 2007

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.

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.*
- » *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.*

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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 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 department lacks a monitoring process to ensure that centers spend funds appropriately, pursue program goals, and report accurate data.*

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.

The enactment of Senate Bill 1710 (SB 1710) mandated the formation of an American Indian Education Oversight Committee (AIEOC) to provide input and approve regulations for the administration of the centers. In accordance with SB 1710, the AIEOC members were selected and the first meeting was held on January 22, 2007.

SB 1710 also mandated new reporting requirements, a competitive application process, and a process for program and fiscal monitoring. The department developed and presented draft regulations and guidelines for the AIEOC's consideration and approval at its meeting scheduled in February 2007 and, if approved, will take effect beginning in fiscal year 2007–08. For fiscal year 2006–07, the department will continue to use the following operational policies and procedures:

- 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 to 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, of which seven were completed. 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.

SB 1710 requires that centers conduct and submit needs assessment results as part of the 2007 through 2012 application cycle. The draft regulations submitted to the AIEOC by the department include a requirement that each center submit a needs assessment as part of its application.

Legislative Action: None.

SB 1710 extended the program until January 1, 2012. However, 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.

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 May 2007

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' 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.

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.

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.*
- *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.*

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» *The university did not consistently disclose its officers' nonsalary compensation, such as housing allowances, to the Board of Regents as required by policy.*

University's Action: Pending.

The university states that by August 2007 it will issue guidance clarifying the proper use of transaction codes within the CPS and, in the future, will restrict the assignment of new codes to the president's office. 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 has developed an automated system to make compensation data for the senior leadership group available for querying and reporting, and is in the process of improving the accuracy and consistency of the data in this system.

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 has 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. As of May 2007 the university indicated that it will soon be interviewing final candidates for this position. The new 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 this 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 it annually identify unauthorized exceptions to compensation policies, the university states the president's office has identified arrangements that may be exceptional in nature by taking a more active role in the oversight of the preparation of executive compensation reports. Further, it indicates that its efforts to improve the clarity and consistency of recordkeeping will allow the university to more easily identify transactions that may be exceptional in nature. 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 most of the exceptions identified in our audit report by either obtaining the regents' approval of those exceptions or notifying the regents about them. The university indicates that a small number of matters were referred to the university's office of the General Counsel or to the appropriate campus in circumstances where the regent's approval would not be appropriate. A few of those issues are still pending. Additionally, the university asserts it corrected all inappropriate forms of retirement-covered compensation we identified and states that its efforts to clarify the use of codes within CPS and increase its audits of retirement-covered compensation should reduce the risk of similar errors occurring 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 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. To ensure the accuracy of the annual report, the university states that campus internal auditors will audit the data and campus administrators must certify the data's accuracy.

California Public Schools

Compliance With Translation Requirements Is High for Spanish but Significantly Lower for Some Other Languages

REPORT NUMBER 2005-137, OCTOBER 2006

California Department of Education's response as of October 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:

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.*

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: None.

➲ The department agrees that translated notices should be sent only to parents who need them. However, the department reports that after considering the expected benefits and related costs of making and supporting such determinations, it deems it more cost-effective to continue the existing processes of providing translated notices to parents.

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: Corrective action taken.

In February 2007 the department sent a letter to county and district superintendents encouraging them to form translation consortia. The department also continues to promote the idea of translation consortia on its Web site and in presentations to professional and field organizations. Further, the department posted new data reports in the clearinghouse making it possible for districts to identify other districts with common translation needs. Finally, the department states that it is not authorized to use funds appropriated for the clearinghouse to pay districts as an incentive to enter translated documents into the clearinghouse. However, the department reports that it continues to use these funds to promote the clearinghouse at meetings and conferences to encourage districts to increase direct participation in the clearinghouse, and to provide promotional mailings to districts.

Department of Education

Its Mathematics and Reading Professional Development Program Has Trained Fewer Teachers Than Originally Expected

REPORT NUMBER 2005-133, NOVEMBER 2006

The Department of Education's and State Board of Education's responses as of October 2007

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 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

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.***
- ***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.***

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» *The State Board of Education relied on the Sacramento County Office of Education to advertise and implement the program.*

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: None.

The statutory provisions for the program remain substantially the same since the conclusion of the audit. The Legislature has not redefined its expectations for the program in terms of the number of teachers to receive the full 120 hours of training, or how it expects such training will translate into greater student achievement. Lacking such expectations, assessing the program's effectiveness towards achieving its ultimate goal of improving student learning remains problematic. Although the Legislature continues to require that Education report statistics on the numbers of teachers trained under the program, we continue to question the value of these reports. Specifically, Education's reporting process continues to utilize the same data collection forms reviewed during the audit, which results in duplicate counts of teachers trained under the program.

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 that it continues to work with the board on expediting the program's reimbursement approval process. Although this process has remained the same since the audit took place in 2006, Education has reported its future plans to expedite reimbursement payments. Specifically, in fiscal year 2008–09, Education expects to change its program guidelines by requiring school districts to obtain SBE's approval to participate in the program at the beginning of the fiscal year. Given that program payments cannot occur until the board has approved a school district's participation in the program, Education expects this upfront approval by the board will eliminate some of the delays noted in the audit report. Further, Education also plans to implement an on-line payment request system that it expects will further reduce Education's reimbursement processing times.

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.

Education reports that it continues to disseminate program information to school districts through its annual notifications and its program's Web site. In addition, Education anticipates that its new on-line system, expected in fiscal year 2008–09, will provide school districts with additional program information, such as their specific funding cap amounts for the 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: Corrective action taken.

Education reported that the program's compliance requirements are continuing to be updated in the audit guides related to the annual audits of school districts. Our independent review of the audit guide published by the Education Audit Appeals Panel for fiscal year 2007–08 shows that the program is now included in the guide. Auditors of local school districts can now refer to Section 19838 of the guide for audit procedures aimed at assessing compliance with the program.

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's Postsecondary Educational Institutions

Stricter Controls and Greater Oversight Would Increase the Accuracy of Crime Statistics Reporting

REPORT NUMBER 2006-032, JANUARY 2007

Responses from institutions we visited and the California Postsecondary Education Commission as of July 2007

Chapter 804, Statutes of 2002, which added Section 67382 to the California Education Code (code section), requires us to report to the Legislature the results of our audit of not less than six California postsecondary educational institutions that receive federal student aid. We were also directed to evaluate the accuracy of the institutions' statistics and the procedures they use to identify, gather, and track data for reporting, publishing, and disseminating accurate crime statistics in compliance with the requirements of the Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics Act (Clery Act). We evaluated compliance with the Clery Act at American River College (American River); California State University, Long Beach (Long Beach); Leland Stanford Junior University (Stanford); University of California, Berkeley (Berkeley); University of California, Los Angeles (UCLA); and University of Southern California (USC).

The code section also requires the California Postsecondary Education Commission (commission) to provide on its Web site a link to the Web site of each California postsecondary institution that includes crime statistics information.

Audit Highlights . . .

Our review of California's postsecondary educational institutions' compliance with the Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics Act (Clery Act), revealed the following:

- *One institution did not correctly convert crimes defined in California law to crimes the Clery Act requires to be reported in the annual security report.*
- *Institutions did not review some potentially reportable crimes to determine if they are reportable under the Clery Act.*
- *Institutions did not correctly identify all reportable locations.*
- *Institutions have not established a written policy or procedure for some of the items described in their annual reports.*
- *The California Postsecondary Education Commission does not ensure that the links that it provides lead to institutions' statistics.*

Finding #1: Failure to correctly classify specific incidents of potentially reportable crime types led institutions to incorrectly report the number of, or miscategorize, crimes.

The Clery Act and federal regulations require eligible postsecondary educational institutions (institutions) to compile crime statistics in accordance with the definitions established by the Uniform Crime Reporting Program of the Federal Bureau of Investigation (FBI). Definitions for crimes reportable under the Clery Act can be found in both federal regulations and the FBI's *Uniform Crime Reporting Handbook* (UCR). If the U.S. Department of Education (Education) finds that an institution has violated the Clery Act by substantially misrepresenting the number, locations, or nature of reported crimes, it may impose a civil penalty of up to $27,500 for each violation or misrepresentation. Additionally, Education may suspend or terminate the institution's eligibility status for federal student aid funding.

The Clery Act requires institutions to compile crime statistics in accordance with the definitions established in the UCR. Although state definitions of crimes often do not precisely match the crimes described in the UCR, there is no comprehensive list converting crimes defined in California law to those reportable under the Clery Act, or identifying crimes that cannot be uniformly converted. Consequently, institutions are responsible for ensuring that they include in their annual reports all reportable crimes and correctly classify crimes and their locations in accordance with the definitions of crimes reportable under the Clery Act. One of the six institutions we reviewed did not correctly convert crimes defined in California law to crimes the Clery Act requires institutions to report in their annual reports, and four institutions either did not review or did not correctly report some crimes in potentially reportable categories. When institutions fail to meet these requirements, they can distort the level of crime occurring on the campuses.

To improve the accuracy and completeness of their data, Berkeley, Long Beach, Stanford, UCLA, and USC should establish procedures to identify crimes defined in California law that cannot be directly converted to reportable crimes and take additional steps to determine if a crime is reportable. Berkeley should also ensure that crimes in California law are correctly converted to crimes the Clery Act requires institutions to report.

University of California—Berkeley's Action: Corrective action taken.

Berkeley indicates that it has developed a procedure to ensure that the crimes identified by the audit as incorrectly included are no longer reported. In addition, Berkeley states that it has created a spreadsheet documenting the review of several types of crimes defined in California law to convert them to Clery Act defined crimes.

California State University—Long Beach's Action: Corrective action taken.

Long Beach indicates that it has altered its crime reporting software to identify Clery Act reportable crimes.

Leland Stanford Junior University's Action: Partial corrective action taken.

Stanford indicates that it intends to implement a process to formalize converting crimes defined in California law into the Clery Act reportable crimes defined by the uniform crime report. For crimes that do not have a clear counterpart, the Clery coordinator reviews the incident report and consults with the campus director of public safety and Education as necessary.

University of California—Los Angeles' Action: Corrective action taken.

UCLA has conducted training and established a single method of coding crime reports to ensure consistency. The records manager conducts monthly audits of crime coding to ensure consistency and accuracy. In addition, the records manager reviews data entered into the records management system and conducts audits of the information on a monthly basis. The analyst and records manager determine the appropriate classification for questionable categories. The analyst reviews the actual crime report, as opposed to the information entered into the record management system, for all Clery reportable crimes, and has created a reference sheet to correctly count alcohol-related crimes. Finally, UCLA is attempting to obtain a software upgrade that will enable its record management system to automatically create its Clery report, and hopes to have a process in place to do so by 2009.

University of Southern California's Action: Pending.

USC indicates that it will obtain information from the Los Angeles Police Department to properly categorize these incidents.

Finding #2: Incomplete data led some institutions to under-report crimes.

Each institution we reviewed used some form of an electronic system to record and track crimes. However, a lack of controls in these systems allowed inaccurate or incomplete information to be entered, and led some institutions to incorrectly report their crime statistics. For example, at Stanford we identified crimes that either were not entered into the system or were entered with an incorrect year. In addition, at UCLA we found instances when the type of crime was not entered in the crime-tracking system for Clery Act reportable crimes, and UCLA subsequently assumed they were not criminal incidents. When institutions do not identify all reportable crimes or enter erroneous information for crimes, they risk misrepresenting the number of crimes occurring on their campuses.

To improve the accuracy and completeness of their data American River, Berkeley, Stanford, and UCLA should establish procedures to verify the integrity of data in their electronic crime-tracking systems.

American River College's Action: Corrective action taken.

American River indicates that it is now using an automated records management system and ensures the integrity of its data through the use of a separate backup server.

University of California—Berkeley's Action: Corrective action taken.

Berkeley indicates that it now conducts a quarterly "gap check" to identify any crimes that have not been entered into the system. In addition, the records unit supervisor maintains documentation regarding any missing case numbers (for example, cancelled case reports).

Leland Stanford Junior University's Action: Corrective action taken.

Stanford states that its records supervisor conducts periodic audits of the crime tracking systems to ensure the integrity of the data in the system.

University of California—Los Angeles' Action: Corrective action taken.

UCLA states that it has taken steps to label all incident reports, whether criminal or otherwise, to ensure that it accurately identifies and sorts all crimes. In addition, UCLA has taken steps to ensure that the date associated with the crime report is the date the crime was reported, and has introduced daily reviews and random monthly audits to ensure accuracy. Reports are generated to identify incidents without a classification, which are then reviewed. Further, each month the analyst randomly selects 10 percent of incident reports for review to verify the classification is correct. In addition, a monthly report identifies that all report numbers are accounted for, all reports have an incident classification, all criminal offenses have a penal code, and all penal codes correspond to the appropriate classification. Moreover, the analyst now reviews the actual crime report to ensure that the location in the record is the location where the crime occurred, rather than the location where the crime was reported.

Finding #3: Failing to collect enough information from campus security authorities and local police agencies can affect crime statistics.

The Clery Act requires institutions to collect crime statistics from campus security authorities and local police agencies. The six institutions we reviewed collect information from various campus security authorities throughout the institutions at least annually. Four of these institutions also request necessary details. However, three institutions did not retain complete records of their requests and responses from campus security authorities.

Because local police agencies may be responsible for responding to certain types of crimes or patrolling designated noncampus and public property areas, institutions must also request information that allows them to determine which additional crimes they should include in their annual reports. Two institutions we reviewed either did not maintain original documents provided by local police agencies or documentation of which crimes they included in their annual reports. Although all incidents reported to campus police departments and local police agencies should be considered, institutions should try to obtain detailed information on every incident reported to avoid over- or under-reporting. Without adequate information, an institution could under-report campus crime because it cannot confirm that it is already aware of the crime, or it could over-report as a result of counting an incident more than once.

To improve the accuracy and completeness of their data, we recommended that American River, Long Beach, Stanford, and USC establish procedures to obtain and retain sufficient information from campus security authorities and local police agencies to determine the nature, dates, and locations of crimes reported by these entities. We also recommended that USC establish procedures to identify all campus security authorities and collect information directly from each source, and that it develop a process to compare the dates that crimes occurred as recorded by the institution to the dates recorded by local police agencies to minimize the potential for duplicate reporting of crimes. Lastly we recommended that Long Beach and USC retain adequate documentation that specifically identifies incidents they include in their annual reports.

American River College's Action: Corrective action taken.

American River indicates that it now sends letters to campus security authorities that explain their role and provide instructions for submitting the requested information. In addition, campus security authorities are provided forms that identify required information and include simple definitions of crimes to help enhance accurate reporting. Further, American River makes all requests for information via e-mail to help document compliance.

California State University—Long Beach's Action: Corrective action taken.

Long Beach indicates that to provide a basis for verification of statistics in its annual report it has revised its process to collect and retain incident information, and has established procedures to ensure data is gathered and retained from local police agencies and campus security authorities for the proper period of time.

Leland Stanford Junior University's Action: Corrective action taken.

Stanford states that its Clery coordinator sent requests for information to all campus security authorities and required responses even if the authority had no crimes to report.

University of Southern California's Action: Partial corrective action taken.

USC states that it maintains original documentation provided by the Los Angeles Police Department. USC did not address our concern regarding a comparison of the dates in its records that crimes occurred to the dates recorded by local police agencies to minimize the potential for duplicate reporting of crimes. USC indicates that it is revising its list of campus security authorities and creating an incident report form for them to use.

Finding #4: Institutions that lack adequate procedures for determining reportable locations risk confusion and inaccurate reporting.

The Clery Act requires each institution to report statistics for crimes committed in certain geographic locations associated with the campus. Although Education's The Handbook for Campus Crime Reporting (Education handbook), which offers additional guidance on compliance with the Clery Act, provides specific examples of how various locations are to be classified, five of the six institutions we reviewed did not correctly identify all reportable locations. Some institutions did not properly identify public property for all years reviewed; incorrectly classified property meeting the definition of a campus location; did not differentiate in their annual reports between crimes occurring on campus and those occurring on certain public properties, such as streets adjacent to the institution; and failed to identify all noncampus locations subject to reporting. Although each campus is unique, it is important that institutions consistently apply the criteria established by Education to accurately classify reportable crimes.

To improve the accuracy and completeness of their data Berkeley, Long Beach, Stanford, UCLA, and USC should establish procedures to accurately identify all campus, noncampus, and public property locations and report all associated crimes.

University of California—Berkeley's Action: Corrective action taken.

Berkeley states that as described in its response to the audit, it has already complied with this recommendation by using the Education handbook definition to compile statistics for two of the three years reported in its 2006 annual report.

California State University—Long Beach's Action: Corrective action taken.

Long Beach states that it has altered its definition of reportable locations to match that of the Education handbook in its 2006 annual report.

Leland Stanford Junior University's Action: Partial corrective action taken.

Stanford indicates that it will contact Education for guidance on the proper designation of certain properties. Further, Stanford will include the Stanford Hospital and the Stanford Linear Accelerator Center as campus locations; and will include the Stanford Sierra Camp and Boathouse as noncampus locations. Finally, its Clery coordinator will review a list of Stanford properties to determine if all campus and noncampus locations have been properly identified.

University of California—Los Angeles' Action: Corrective action taken.

UCLA indicates that it now obtains a complete list of property from its Space Management Division annually, and a complete list of Greek housing from the fraternity and sorority relations staff. Further, it has reviewed its property and redrawn the campus boundaries for the purpose of identifying reportable locations. It also stated that the crime analyst ensures all locations are properly identified and associated crimes are accurately reported.

University of Southern California's Action: Partial corrective action taken.

USC indicates that it has spent time to educate staff and review local police reports to improve reporting accuracy of the crimes reported by local police. It indicates that it is also expanding its review process to classify or reclassify new properties and those whose use changes. USC did not address our concerns regarding the correction of any incorrect property classifications where the use of the property has not changed.

Finding #5: The statistics institutions report to Education do not always match the statistics in their annual security reports.

In addition to disclosing crime statistics in their annual reports, institutions must submit the information to Education, using a form on Education's Web site. Although we would expect these statistics to mirror one another, five institutions had discrepancies between the number of crimes published in their annual reports and those they submitted to Education. Among the causes of the discrepancies were institutions' errors when completing Education's online form, errors in the institutions' annual reports, the discovery of misplaced information, and corrections institutions made after obtaining additional information. Errors made in reporting to Education and when preparing annual reports distort the actual levels of crime experienced by the institutions and result in unreliable resources for current and prospective students.

To improve the accuracy and completeness of their data, we recommended that Berkeley, Long Beach, Stanford, UCLA, and USC establish procedures to minimize data entry errors in their annual reports and in their annual submissions to Education.

University of California—Berkeley's Action: Partial corrective action taken.

Berkeley indicates that it has created a checklist to ensure that all data submitted by campus security authorities is correctly included in both its annual report and the data it submits to Education. The annual report was not yet due as of the date of Berkeley's response, so the new procedure had not been fully implemented.

California State University—Long Beach's Action: Partial corrective action taken.

Long Beach states that it has established written procedures to minimize data entry errors and has assigned responsibility for these tasks to a single position. The annual report was not yet due as of the date of Long Beach's response, so the new procedure had not been fully implemented.

Leland Stanford Junior University's Action: Partial corrective action taken.

Stanford states that its Clery coordinator and records supervisor will cross check data entries prior to the submission of statistics. The annual report was not yet due as of the date of Stanford's response, so the effectiveness of its corrective action could not be fully assessed.

University of California—Los Angeles' Action: Partial corrective action taken.

UCLA states that it is confident that by addressing and correcting data integrity issues the concerns regarding the statistics reported to Education will be corrected. In addition, both the crime analyst and information systems manager now review all reported Clery statistics for data entry errors before they are finalized. The annual report was not yet due as of the date of UCLA's response, so the effectiveness of its corrective action could not be fully assessed.

University of Southern California's Action: Partial corrective action taken.

USC indicates that it will continue its review of statistics to minimize the potential for the duplicate reporting of crimes. The annual report was not yet due as of the date of USC's response, so the effectiveness of its corrective action could not be fully assessed.

Finding #6: Some Institutions did not comply with the Clery Act requirements to disclose campus security policies.

The Clery Act requires that each institution disclose its current campus security policies. While all six institutions we reviewed made good-faith efforts to fully disclose these policies, two institutions did not fully comply in their disclosures. Although one institution disclosed information for all seven of the categories we reviewed, its sexual assault information did not include all the components required by the Clery Act. Complying with the Clery Act provides students and employees at these institutions with important information concerning their safety. In addition, California Education Code, Section 67382(c), suggests that institutions establish and publicize a policy that allows victims or witnesses to report crimes to the institutions' police agencies or to a specified campus security authority on a voluntary, confidential, or anonymous basis, and federal regulations require institutions offering confidential or anonymous reporting to disclose its availability in their annual reports. Unless institutions establish and inform students and staff of the availability of an anonymous reporting system, they may not have a clear picture of the degree of sexual violence occurring on their campus and surrounding communities.

To ensure compliance with the Clery Act, USC should enhance the disclosures regarding sexual assaults in its annual report to fully meet statutory requirements. Long Beach should establish procedures to ensure adequate disclosure of the availability of anonymous and confidential reporting to its campus community.

University of California—Long Beach's Action: Corrective action taken.

Long Beach states that it has developed a procedure to ensure adequate disclosure of the availability of anonymous reporting.

University of Southern California's Action: Partial corrective action taken.

USC stated that it reviewed and amended its sexual assault policy contained in its annual security report to meet statutory requirements. Although USC's amended policy now contains a section titled "*What To Do If You Are Sexually Assaulted*", it still lacks certain statutorily required wording, including the importance of prompt reporting of a sex offense and of preserving evidence following a sexual assault.

Finding #7: Some institutions have not established all the policies or procedures described by their annual reports.

A major component of Clery Act compliance is the disclosure of policy statements in the annual report. The Clery Act outlines numerous campus security policies that institutions must disclose, and the Education handbook provides guidance on the minimum requirements for specific information that the report must include. However, the policies and procedures described in the annual report must also accurately reflect the institution's unique security policies, procedures, and practices, and if the institution does not have a particular policy or procedure, it must disclose that fact. Although the institutions we reviewed generally disclosed the information required by the Clery Act in their annual reports, most campuses were unable to provide us with the policies and procedures to support some of the disclosures they had made in those reports. In addition, the Education handbook states that to keep the campus community informed about safety and security issues, an institution must alert the campus community of reportable crimes considered an ongoing threat to students and employees in a manner that is timely and will aid in the prevention of similar crimes. Because of its potential to prevent crimes, each institution is required to have a policy specifying how it will issue these warnings. Because the Clery Act does not define timely, we expected institutions to have established their own definitions. However, two institutions had not established guidelines or time frames for reporting incidents to the campus community.

To ensure compliance with the Clery Act, we recommended that American River, Long Beach, Stanford, and USC establish comprehensive departmental policies that support disclosures made in their annual reports, and establish a policy to define timely warnings and establish procedures to ensure that they provide timely warnings when threats to campus safety occur.

American River College's Action: Pending.

American River reported it was in the process of updating its general orders, and expected that it would complete this process by November 1, 2007.

California State University—Long Beach's Action: Corrective action taken.

Long Beach states that it has developed policies and procedures that support the disclosures made in the annual report and has integrated them into the campus police rules and regulations manual, including a policy to define timely warnings.

Leland Stanford Junior University's Action: Pending.

Stanford states that it will formalize aspects of existing written procedures regarding timely warnings, and will review and improve its written policies.

University of Southern California's Action: Pending.

USC states that it is updating its policy manual. In addition, USC states that it has developed a new timely warning policy, which will be published in the 2007 annual security report, and has amended its internal timely warning procedures.

Finding #8: One institution did not notify all current and prospective students and employees of the availability of its annual report.

Federal regulations require institutions to distribute their annual reports to all enrolled students and current employees by October 1 of each year through appropriate publications or mailings. In addition, institutions must notify prospective students and employees of the availability of their annual reports. American River did not distribute its annual report or satisfactorily notify students and employees of its availability during the period we audited. The annual report is only effective in educating students and staff about crime on campus and on the institution's security policies and procedures when students and staff are aware of its availability.

To ensure compliance with the Clery Act, American River should establish procedures to ensure that the campus community is informed of the availability of the annual report.

American River College's Action: Corrective action taken.

American River indicates that it now uses a variety of documents to notify students, staff, and faculty of the availability of its annual report.

Finding #9: The commission does not ensure a link exists to institutions' crime statistics.

State law requires the commission to provide a link to the Web site of each California institution containing crime statistics information. To fulfill this requirement, the commission provides links on its Web site to connect users to the selected institution's summary information on Education's Web site. The commission believes that this ensures uniform reporting of crime statistics, provides interested persons with a common reporting format for comparison purposes, reduces the reporting burden on institutions, and makes the best use of the commission's scarce resources. However, the commission was unaware that five institutions listed on its Web site had not submitted crime statistics to Education's Web site. Although the commission has procedures in place to verify that it includes a valid link to Education's summary information for each institution, it does not ensure that the summary page contains a link to a valid crime statistics report. The commission stated that in the future it will identify institutions whose pages on Education's Web site do not contain the required crime statistics information and will determine each institution's status.

To ensure that its Web site contains a link to all institutions' crime statistics, the commission should continue with its plan to test the validity of its links.

California Postsecondary Education Commission's Action: Corrective action taken.

The commission indicates that it has developed a program to accomplish this task, and conducts verification checks monthly.

Home-To-School Transportation Program

The Funding Formula Should Be Modified to Be More Equitable

REPORT NUMBER 2006-109, MARCH 2007

California Department of Education's response as of September 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review the California Department of Education's (Education) disbursement of Home-to-School Transportation (Home-to-School) program funds to identify any inequities. Specifically, we were asked to review the funding formula that Education uses to determine Home-to-School program payments to school districts. The audit committee also asked us to determine how the program is funded and what roles Education and school districts have in determining the funding levels. In addition, we were asked to compare data related to the number and percentage of students receiving transportation services, the amount paid for the Home-to-School program in total and per student, the actual cost of transporting students in total and per student, and the excess cost over Home-to-School program payments by school district and region for both regular and special education students to determine if and why variances exist. Further, the audit committee asked that we determine how school districts fund the difference between what is paid to them by Education and their actual cost, and evaluate, to the extent possible, whether this practice affects other programs. Additionally, the audit committee asked us to determine, to the extent possible, whether any correlations exist between higher transportation costs and staffing levels.

Audit Highlights . . .

Our review of the Home-to-School Transportation (Home-to-School) program administered by the California Department of Education found that:

- ***The current legally prescribed funding mechanism prevents some school districts from receiving Home-to-School program funds because of the basis of allocation.***
- ***Although the annual budget act increases the Home-to-School program funds to account for the increases in the statewide average daily attendance, these increases are less than the student population growth some school districts have experienced over the years.***
- ***Urban school districts received less overall Home-to-School program payments per student transported than rural school districts ($559 versus $609) and paid for more overall costs per student transported from non-Home-to-School program funds ($828 versus $299).***
- ***While all school districts typically incurred higher costs to transport a special education student, such costs were higher in rural school districts ($5,315) than in urban school districts ($4,728).***
- ***Staffing levels and student test scores bear no relationship to the amount of transportation expenditures the school districts paid per student from non-Home-to-School program funds during fiscal year 2004–05.***

Finding: The prescribed funding formula does not allow some school districts to receive transportation funding.

Home-to-School program funding is contingent upon receiving funds for this program in the immediately preceding fiscal year. Consequently, some school districts and county offices of education (school districts) are not eligible to receive these funds. Current laws require that Education allocate Home-to-School program funds to each school district based on the lesser of its prior year's allocation or approved cost of providing transportation services, increased by the amount specified in the budget act. School districts that did not previously receive Home-to-School program allocations for special education transportation, regular education transportation, or both, are not eligible to receive these allocations under the current laws. Furthermore, some school districts have experienced dramatic increases in student population over the years. Although the funding method provides for some adjustments for the increase in statewide average daily attendance, the allocations have not always increased at the same rate as the increase in student population at individual school districts.

To determine the fiscal impact on school districts that do not receive the Home-to-School program funds, we recommended that Education identify all school districts that provide transportation services to their students but are not eligible to receive Home-to-School program funds for regular education transportation, special education transportation, or both. In addition, we recommended that Education determine the actual costs these school districts incur and the funding sources they use to pay them. Further, we recommended that Education seek legislation to revise the current laws to ensure that all school districts that provide transportation services to regular education, special education, or both, are eligible for funding. To ensure that school districts are funded equitably for the Home-to-School program, we also recommended that Education seek legislation to revise the law to ensure that funding is flexible enough to account for changes that affect school districts' transportation programs, such as large increases in enrollment.

Education's Action: Partial corrective action taken.

Education noted that it does not have the resources to identify all the school districts that provide transportation services to their students but are not eligible to receive Home-to-School program funds for regular education transportation, special education transportation, or both; and determine the actual costs these school districts incur and the funding sources they use to pay them. However, Education stated that it submitted a Budget Change Proposal for the fiscal year 2008–09 budget for a new consultant position to, among other things, develop a pupil transportation funding reform proposal aimed at ensuring that all eligible school districts receive state funds for the Home-to-School program.

California State University

It Needs to Strengthen Its Oversight and Establish Stricter Policies for Compensating Current and Former Employees

REPORT NUMBER 2007-102.1, NOVEMBER 2007

California State University's response as of October 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the compensation practices of the California State University (university).[1] Specifically, the audit committee asked us to identify systemwide compensation by type and funding source, to the extent data are centrally maintained and reasonably consistent among campuses. The audit committee also asked us, subject to the same limitations, to categorize by type and funding source the compensation of highly paid individuals receiving funds from state appropriations and student tuition and fees. In addition, for the most highly paid individuals, the audit committee asked us to identify any additional compensation or employment inducements not appearing in the university's centrally maintained records, such as those recorded in any employment agreements with the university. Further, the audit committee asked us to review any postemployment compensation packages and identify the terms and conditions of transitional special assignments for highly paid individuals, including top executives and campus presidents, who left the university in the last five years. Finally, the audit committee asked us to determine the extent to which the university's compensation programs and special assignments are disclosed to the board of trustees (board) and to the public, including the types of programs that exist, the size and cost of each, and the benefits that participants receive. To the extent that this information is available and is not publicly disclosed, the audit committee asked us to include these items in our report.

Audit Highlights . . .

Our review of the California State University's (university) compensation practices revealed the following:

- *The university has not developed a central system enabling it to adequately monitor adherence to its compensation policies or measure their impact on university finances.*
- *Average executive compensation increased by 25.1 percent from July 1, 2002, through June 30, 2007, with salary increases contributing the most to the growth.*
- *The board of trustees (board) has justified increasing executive salaries on the basis that its executives' cash compensation, excluding benefits and perquisites, lags those of comparable institutions, but concerns have been raised about the methodology used.*
- *The university has three executive transition programs that provide postemployment compensation packages to departing executives, in addition to the standard retirement benefits available to eligible executives.*
- *Some Management Personnel Plan employees received questionable compensation after they were no longer providing services to the university or while they were transitioning to faculty positions.*
- *The discretionary nature of the university's relocation policy can result in questionable reimbursements of costs for moving household goods and closing costs associated with selling and purchasing residences.*

Finding #1: The university has not developed a central system sufficient for monitoring compliance with its compensation policies.

The chancellor's office establishes systemwide compensation policies but does not have a system in place that allows it to adequately monitor adherence to those policies and to measure their impact on university finances. Specifically, the chancellor's office does not maintain systemwide compensation data by type and funding source, either by individual or in total. The lack of this data impairs the ability of the chancellor's office to provide effective oversight of the university's compensation programs. The executive vice chancellor and chief financial officer (executive vice chancellor) indicated that it was never the intent of the chancellor's office to have detailed systems in place to monitor employee payments and to ensure that payments are consistent with policy, as it believes that is a campus responsibility. Accordingly, the financial tools available to the chancellor's office for payroll purposes reflect its view that campuses are delegated the authority and responsibility to monitor compliance with university

[1] The audit committee also requested that we review the university's hiring practices and employment discrimination lawsuits. The results of our review of these areas were included in a separate report (2007-102.2), which we issued in December 2007.

policy. The executive vice chancellor cited the standing orders of the board and the board's statement of general principles as the general policy basis for this delegation. Although we recognize that campuses have primary responsibility for implementing compensation policies, it is important for the chancellor's office to have sufficient data to ensure that the campuses appropriately carry out their responsibilities.

To provide effective oversight of its systemwide compensation policies, the university needs accurate, detailed, and timely compensation data. The university should create a centralized information structure to catalog university compensation by individual, payment type, and funding source. The chancellor's office should then use the data to monitor the campuses' implementation of systemwide policies and to measure the impact of systemwide policies on university finances.

University's Action: Pending.

The university reports that it will explore the best way to address these issues including making appropriate coding changes to improve the accuracy and detail provided by the existing systems. Its central administration will also develop and implement training to improve the consistency in coding and reporting of compensation matters by campus personnel. Finally, the university states that it will enhance monitoring at the system level through more frequent reviews of campus practices and will discuss with its board the degree to which it wants centralized monitoring to occur.

Finding #2: The board has continually justified increasing executive salaries on the basis that its executives' cash compensation lags that of comparable institutions.

Average executive compensation increased by 25.1 percent from July 1, 2002, through June 30, 2007. Because this increase was greater than that of other employee classifications, we examined the growth in the various components that make up executive compensation—salaries, housing allowances, and automobile allowances—over the five-year period. We found that salary increases contributed the most to this growth, with the board approving salary increases on three separate occasions. The salary increases for executives ranged from an average of 1.68 percent to 13.7 percent. The board has continually justified increasing executive salaries on the basis that its executives' cash, or salary, compensation lags behind that of comparable institutions. However, as early as October 2004, the California Postsecondary Education Commission (commission), the entity that was involved with executive compensation studies until that time, raised concerns that the methodology used in making such comparisons did not present a complete picture of the value of individual compensation packages because it did not consider benefits and perquisites provided to executives, which can be substantial. Despite these concerns and the absence of further commission involvement in surveys of executive compensation, the university proceeded to use a consulting firm to perform surveys of the comparison institutions using the questioned methodology. Further, documents indicate that the board approved executive salary increases in October 2005 and January 2007 based only on the lag in cash compensation.

The commission and the Legislative Analyst's Office (legislative analyst) expressed further concerns in 2007 about the existing methodology used in these types of comparisons. Nevertheless, in September 2007 the board granted its executives another raise averaging 11.8 percent. Further, the chancellor recommended that the board adopt a new formal executive compensation policy and that the board continue to have a salary target focused on the average cash compensation for similar positions at comparable institutions. In response to these recommendations, the board adopted a new executive compensation policy and resolved that it aims to attain parity for its executives and faculty by fiscal year 2010–11.

We asked the chancellor's office why the university continued to justify increases in compensation for its executives based on a methodology that has been questioned by the commission and the legislative analyst. The chancellor's office responded that the university did not believe it appropriate to deviate from a methodology that was agreed upon years ago by the various interested parties, including the commission and the legislative analyst. However, as these are now the same parties that are raising concerns, we believe it is time for the university to work with the interested parties to develop a more appropriate methodology that considers total compensation.

We recommended that the board consider total compensation received by comparable institutions, rather than just cash compensation, when deciding on future salary increases for executives, faculty, and other employees. The university should work with interested parties, such as the commission and the legislative analyst, to develop a methodology for comparing itself to other institutions that considers total compensation. If the university believes it needs a statutory change to facilitate its efforts, it should seek it.

University's Action: Pending.

The university reports that it will continue to work with interested parties in an effort to develop a methodology for use of total compensation analysis for executives, faculty, and other employees. The university states that it is committed to using the best tools available as long as lag comparisons for executives, faculty, and other employees are all based on the same compensation elements.

Finding #3: The university has generous postemployment compensation packages for departing executives.

The university typically offers its departing executives a transition program that often provides a generous postemployment compensation package. This program is in addition to the standard retirement benefits the university provides to eligible executives, including retirement income, medical and dental coverage, and voluntary retirement savings plans. Although the original transition program has been overhauled a few times, leaving the university with three transition programs currently in use, each departing executive is eligible for the program that was in place at his or her time of appointment. The terms of the transition agreement offered to a departing executive vary with the transition program the executive is eligible for but can include one year of paid leave, lifetime tenure as a trustee professor at a campus, or an alternative agreement negotiated by the chancellor.

In November 2006, after media criticism of existing postemployment compensation packages, the board passed a resolution requiring the chancellor to provide every board member with a copy of each final transition agreement and to submit an annual report summarizing all existing transition agreements. However, the annual report contains no information on the status of accomplishments or deliverables that former executives may have agreed to provide the university as part of their transition agreements, and disclosure does not occur until after the chancellor has reached a final agreement with a departing executive. Although the board has decided not to participate in negotiating transition agreements, it is important that the board continue to monitor the chancellor's administration of the executive transition program to ensure that the agreements departing employees receive are prudent and that intended cost savings are achieved for the university.

We recommended that the board continue to monitor the executive transition programs to ensure that the chancellor administers them prudently and that intended cost savings are achieved for the university. In addition, the board should require the chancellor to include in the transition agreements clear expectations of specific duties to be performed, as well as procedures for the former executives to report on their accomplishments and status of deliverables. Further, the board should require the chancellor to include information in his annual report on the status of accomplishments and deliverables associated with transition agreements.

University's Action: Partial corrective action taken.

The university reports that the chancellor already has begun to include in transition agreements clear expectations regarding specific duties to be performed by executives. In addition, the university states that a report of accomplishments and deliverables will be added to the annual report. Finally, the board will consider whether it wishes to take specific action on this matter.

Finding #4: The university paid questionable compensation to management personnel no longer performing services for the university.

The paid leaves of absence the university provides as part of transition programs are intended only for departing executives. However, the university operates under a very broad policy for granting paid leaves of absence for Management Personnel Plan employees (management personnel). Title 5, Section 42727, of the California Code of Regulations, which addresses professional development, specifies that management personnel may participate in programs and activities that develop, update, or improve their management or supervisory skills. The programs and activities may include "professional leaves, administrative exchanges, academic coursework, and seminars." Management personnel may participate in such programs and activities only after the chancellor or campus president grants approval and only to the extent that funds are available. The regulations do not sufficiently define the criteria that must be met before a paid leave will be granted, and it does not establish time restrictions for a paid leave.

Our review confirms the need for the university to strengthen its regulations and policies in this area. In reviewing a sample of personnel files at the chancellor's office and various campuses, we found instances in which management personnel received questionable compensation after they were no longer providing services to the university or while they were transitioning to faculty positions. For example, we found that one individual, who received compensation totaling $102,000 during a seven-year leave on the premise that he was gaining experience that would benefit the university on his return, never returned to university employment. We also noted that one individual was granted a future leave of absence with pay to transition from an administrative position to a faculty position.

We recommended that the university work through the regulatory process to develop stronger regulations governing paid leaves of absence for management personnel. The improved regulations should include specific eligibility criteria, time restrictions, and provisions designed to protect the university from financial loss if an employee fails to render service to the university following a leave. Further, the board should establish a policy defining the extent to which it wants to be informed of such leaves of absence for management personnel.

University's Action: Pending.

The university reports that while balancing the need for consistency with the need for some administrative flexibility the board will consider actions that can strengthen the process for granting leave of absences for management personnel. The board will also consider development of criteria regarding eligibility, time limitations, and fiscal protective measures.

Finding #5: The university exercises considerable discretion in paying relocation costs for new employees.

The university has established a broad policy for paying costs related to moving and relocation (collectively referred to here as relocation) for its employees. The policy provides that incoming employees may receive reimbursement for actual, necessary, and reasonable expenses but includes few monetary limits for reimbursable expenses. Further, although the policy identifies the types of expenses that can be reimbursed, it contains clauses permitting the chancellor or campus presidents to grant exceptions. The chancellor determines the amounts of relocation reimbursements for executives, campus presidents, and management personnel in the chancellor's office, and the campus presidents determine the amounts for management personnel and faculty at their respective campuses. Neither the chancellor nor the campus presidents are required to obtain the approval of the board for relocation reimbursements, and they typically do not disclose these payments to the board. The discretionary nature of the university's policy can result in questionable reimbursements for costs, such as those for moving household goods and closing costs associated with selling and purchasing residences. These costs can be considerable. For example, we noted that the university reimbursed one individual for $65,000 in closing costs and $19,000 in moving expenses.

We recommended that the university strengthen its policy governing the reimbursement of relocation expenses. For example, the policy should include comprehensive monetary thresholds above which board approval is required. In addition, the policy should prohibit reimbursements for any tax liabilities resulting from relocation payments. Finally, the board should require the chancellor to disclose the amounts of relocation reimbursements to be offered to incoming executives.

University's Action: Pending.

The university reports that the board will consider means of strengthening the controls related to reimbursement of relocation expenses. The board will also review the amount of discretion given to system executives and determine the extent to which it wishes to review or approve any such expenses. Finally, the university states that the chancellor will disclose the amounts of reimbursements offered to incoming executives.

Finding #6: The university's policy on dual employment is limited.

The university has established a dual-employment policy that allows its employees to have jobs outside the university system as long as no conflicts of interest exist. However, the policy does not require employees to obtain prior approval for outside employment, nor does it require them to disclose that they have such employment. Thus, the university is unable to adequately determine whether employees have outside employment in conflict with their university employment.

The university should work to strengthen its dual-employment policy by imposing disclosure and approval requirements for faculty and other employees, including management personnel. If the university believes it needs a statutory change to facilitate its efforts, it should seek it.

University's Action: Pending.

The university reports that it will continue to work through the collective bargaining and regulatory processes to strengthen the outside employment policy for faculty. It strongly favors an information process that will allow for the identification of any conflict of commitment prior to the start of any outside employment. The university states that it will adopt for management personnel similar requirements to those adopted for faculty.

California State Polytechnic University, Pomona

Investigations of Improper Activities by State Employees, February 2007 Through June 2007

INVESTIGATION I2007-0671 (REPORT I2007-2), SEPTEMBER 2007

California State Polytechnic University, Pomona's response as of September 2007

We investigated and substantiated an allegation that an employee with the California State Polytechnic University, Pomona (Pomona), inappropriately used university computers to view pornographic Web sites.

Investigative Highlight . . .

An employee at the California State Polytechnic University, Pomona, admitted, when interviewed, to viewing pornographic Web sites regularly using university computers.

Finding: The employee misused state resources to engage in improper activities.

We asked Pomona to assist us in the investigation, and we substantiated the allegation. Pomona found that the official repeatedly used university computers to view Web sites containing pornographic material. State laws prohibit employees from using public resources, such as time and equipment, for personal purposes. In addition, these laws require employees to devote their full time and attention to their duties, and prohibit individuals employed by the State from using a state-issued computer to access, view, download, or otherwise obtain obscene matter. Specifically, Pomona found that the official viewed approximately 1,400 pornographic images on two university computers during several weeks in 2006 and also from February to May 2007. Pomona was unable to review the official's complete Internet usage because the settings on the official's main computer only allowed for a two-month retention period of Internet activity. When interviewed, the official admitted to viewing pornographic Web sites regularly using university computers.

Pomona's Action: None.

➲ Pomona indicated that as of the issue date of our report, the official is no longer working on campus. Pomona negotiated a resignation with the official and permitted the official to exhaust all earned leave credits and other paid leave.

Pomona indicated that it has an Appropriate Use Policy for Information Technology and that it is committed to taking appropriate action when notified of employees who access pornographic materials on the Internet. However, Pomona did not indicate that it implemented any new controls or software filters that would prevent any future access to pornographic Web sites by employees.

Updated information as of January 2008: None.

➲ The department failed to provide a response.

California State University

It Is Inconsistent in Considering Diversity When Hiring Professors, Management Personnel, Presidents, and System Executives

REPORT NUMBER 2007-102.2, DECEMBER 2007

California State University's response as of November 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the California State University's (university) practices for hiring to determine how it ensures that faculty and executives reflect the gender and ethnicity of the university they serve, the State, and the academic marketplace.[1] As part of our audit, we were asked to determine how the university develops hiring goals and how it monitors progress in meeting those goals. In addition, we were to gather and review the university's statistics on its hiring practices and results over the last five years and, to the extent possible, present the data collected by gender, ethnicity, position, and salary level.

Audit Highlights . . .

Our review of California State University's (university) hiring processes and employment discrimination lawsuits revealed the following:

- ***The university has issued little systemwide guidance to the campuses regarding the hiring process.***
- ***Campuses are inconsistent in their consideration of gender and ethnicity when hiring assistant, associate, and full professors.***
- ***Campuses use differing levels of detail when estimating the percentage of qualified women and minorities available for employment, decreasing the university's ability to effectively compare data among campuses.***
- ***Campuses have hiring policies that vary in terms of the amount of guidance they provide search committees for Management Personnel Plan employees, and one campus has developed no policies for these positions that relate to nonacademic areas.***
- ***While the hiring process for presidents requires input from many stakeholders, the hiring of system executives is largely at the discretion of the chancellor in consultation with the board of trustees.***
- ***As of June 30, 2007, the university spent $2.3 million on settlements resulting from employment discrimination lawsuits filed during the five-year period we reviewed, and $5.3 million for outside counsel in defending itself against such lawsuits.***

Finding #1: Campuses are inconsistent in their approaches to considering diversity in their hiring processes.

The chancellor's office and the board of trustees (board) of the university, who delegate the hiring authority of assistant, associate and full professors (professors) to the campuses, have not adopted systemwide guidance to aid in standardizing the hiring process. As a result, the five campuses we reviewed use different methods to consider gender and ethnicity in the hiring of professors. Although California's Proposition 209 specifically prohibits the university from giving preferences to women or minorities during the hiring process, these requirements coexist with federal affirmative action regulations and thus are not intended to limit employment opportunities for women or minorities.

During the position allocation phase of the hiring process for professors, the campuses we reviewed do little, if anything, in considering gender and ethnicity. For instance, just one of the five campuses we reviewed encourages departments to consider faculty diversity at this stage. We acknowledge that departments can choose to hire professors in a specialized field of study in which proportionately fewer women and minorities exist to meet reasonable academic needs. However, when flexibility exists, they should be open to the idea of recruiting new professors from those disciplines or areas of specialization that will not decrease the likelihood of hiring female or minority professors.

Further, the California Faculty Association recommends that search committees review their campuses' affirmative action plans so they are aware of underrepresentation and the actions that administrators have recommended to improve recruitment efforts to reach women

[1] The audit committee also requested that we review the university's compensation practices. The results of our review of those practices were the subject of a separate report (2007-102.1) issued November 6, 2007.

and minorities. Nevertheless, the campuses we reviewed generally did not share information from the affirmative action plans with search committees. Additionally, although women and minority professors can provide search committees with different perspectives when evaluating candidates, the campuses we reviewed generally did not have written policies that address gender and ethnic representation on such committees. Further, the chancellor's office has not issued guidance on this matter. As a result, some campuses consider the gender and ethnic composition of search committees, while others forbid it.

Additionally, to analyze their employment processes in accordance with federal regulations, campuses distribute surveys to all job applicants to determine their gender and ethnicity. The University of California has issued guidelines that state that if women and minority applicants are not present in the applicant pool at about the rate of their estimated availability in the corresponding labor pool, campuses should review recruitment and outreach efforts and can consider reopening the search with expanded inclusive recruitment efforts. However, the chancellor's office has not issued guidance in this area. Not performing such comparisons increases the risk that departments are unaware of the need to perform more inclusive outreach.

Because applicants are not required to submit the surveys containing their gender and ethnicity, it is not unexpected that response rates can be low. During our review of the hiring processes at five campuses, we noted that one campus sent out a reminder e-mail to applicants requesting that they complete and submit the forms containing their gender and ethnicity, even if they decline to disclose their gender and ethnicity. The campus notes that while it does not typically send reminders to applicants, it does so when response rates are unreasonably low. This practice seems a promising measure to increase the low response rates cited by campuses as a reason why comparing applicant pool data with labor pool data often is not meaningful.

We recommended that the university issue systemwide guidance on the hiring process for professors to ensure it employs hiring practices that are consistent with laws and regulations and among campuses. This guidance should include the development of position descriptions that are as broad as possible, the use of affirmative action plans to familiarize search committees with estimated availability for women and minorities, the development of alternatives for including women and minorities on search committees, a requirement to compare the proportion of women and minorities in the total applicant pool to the proportion in the labor pool to help assess the success of their outreach efforts, and the distribution of reminders to applicants requesting them to submit information regarding their gender and ethnicity.

University's Action: Pending.

The university stated that the chancellor's office will include guidance in its faculty hiring guidelines to campuses on developing position descriptions as broadly as possible consistent with academic needs and the university's commitment to inclusiveness, having search committees review information in the affirmative action plans, devising alternatives to broaden the perspective of search committees and increase the reach of the search, and using applicant pool response data as one means of assessing the effectiveness of recruitment efforts. The university also stated that it will notify campus officials that they may send reminders to applicants regarding the submission of their gender and ethnicity, but that such reminders should clearly explain the use of the data collected and the applicants' rights to decline to submit such information. The university stated that it will give careful consideration to whether any action or guidance could be viewed as an illegal "preference" in violation of Proposition 209.

Finding #2: Campuses are inconsistent in how they conduct their availability analyses.

Because the chancellor's office does not provide campuses with a uniform method for determining availability, campuses have some latitude in deciding the factors they will consider. Availability is an estimate of the number of qualified women or minorities available for employment in a given job classification expressed as a percentage of all qualified persons available for employment in the comparable labor pool. Because, according to the university, campuses have different recruitment areas, specialties, and positions, the campuses each determine their own availability. However, our review of the availability analyses for various university campuses revealed that the reasonable recruitment area for professors is nationwide. Therefore, we believe that a uniform method of determining availability for professors in the reasonable recruitment area is possible, appropriate, and necessary.

We also noted differing levels of detail in campus availability analyses in their affirmative action plans. For instance, three of the five campuses we reviewed presented an aggregate analysis for professors campuswide rather than comparing the gender and ethnicity of their current professors in each department to those available in the labor pool. The differing levels of detail decrease the university's ability to effectively compare data among campuses.

We recommended that the university devise and implement a uniform method for calculating availability data to better enable it to identify and compare availability and goals systemwide and among campuses. Further, it should direct campuses to compare and report the gender and ethnicity of their current workforce to the labor pool by individual department to ensure that goals are meaningful and useful to those involved in the hiring process.

University's Action: Pending.

The university asserted that it will establish a task force comprised of campus officials in order to identify a workable method for uniform calculating of availability data. The university also indicated that it will identify the appropriate levels for data comparisons, stating that in some cases this may be at the department level, school, or other division level.

Finding #3: The hiring process lacks consistent training.

Some campuses have more detailed procedures than others to maintain the integrity of the hiring process and to ensure that search committee members are aware of applicable laws and regulations. For instance, some campuses require search committee members to attend training regarding the hiring process while others do not. As a result, not all of the departments we reviewed were aware of campus hiring protocols. For example, although the collective bargaining agreement between the board and the California Faculty Association requires that search committees be elected and consist of tenured professors, some departments do not elect their search committee members. Further, this lack of guidance may have contributed to one campus developing a policy that requires the consideration of gender or ethnicity in hiring decisions. This policy is inconsistent with what other campuses are doing: the remaining four campuses we reviewed indicated that gender or ethnicity would never play a role in their hiring decisions because Proposition 209 prohibits preferences based on these factors.

We recommended that the university issue systemwide guidance that instructs campuses to require search committee members to receive training offered at the campus level regarding the hiring process, federal regulations, Proposition 209, and other relevant state and federal laws. Additionally, we recommended that the university take action to ensure that campuses have departments elect faculty to serve on search committees to help ensure that searches are conducted in accordance with the collective bargaining agreement and campus policies.

University's Action: Pending.

The university indicated that it will provide guidance to the campuses on the need to require training and will explore the possibility of utilizing online training to assist in meeting this requirement. Additionally, the university stated that it will remind the campuses of the requirement to elect faculty members to search committees and will ensure that the requirement is a part of campus faculty hiring procedures.

Finding #4: Campuses' hiring processes for management personnel vary and they are inconsistent in considering diversity in recruiting for these positions.

Similar to the hiring authority the university has delegated to campuses for professors, it has also delegated authority to the campuses to develop policies for hiring Management Personnel Plan employees (management personnel). Also, as with the hiring of professors, the university has not adopted systemwide guidance to aid in standardizing the hiring process for management personnel. Thus, it is not surprising that campuses we reviewed have developed hiring policies that vary in the amount of guidance they provide search committees on how to conduct the search process. For instance, only one of the five campuses we reviewed has developed policies that address each of the key steps in the hiring process for both academic and nonacademic management personnel, while some of the remaining campuses allow search committees for management personnel positions discretion in conducting the hiring process. In fact, one campus has not developed any formal written policies to govern the hiring of nonacademic positions.

Search committee members can be appointed or elected to serve depending on their position or campus and are generally responsible for conducting the search process for management personnel. Because these responsibilities are crucial to a hiring process that is fair and equitable, composition of the search committee is an important consideration. For instance, women and minorities can provide search committees with different perspectives when evaluating candidates. However, assessment of the gender and ethnic composition of search committees is not specifically required.

We have similar concerns regarding inconsistencies in campuses' approaches to considering gender and ethnicity at various stages in the hiring process for academic management personnel to those we express for hiring professors. Campuses we reviewed generally did not share information in their affirmative action plans with search committees when planning the search process for academic management personnel in order to make progress in achieving equal employment opportunity for underrepresented groups. Further, although federal regulations require contractors, such as the university's 23 campuses, to perform in-depth analyses of their total employment processes to determine whether and where impediments to equal opportunity exist, most campuses we reviewed do not require an assessment of applicant pool data to evaluate their success in recruiting women and minorities. Moreover, because applicants are not required to submit the surveys containing their gender and ethnicity, response rates can be low, thus inhibiting the meaningfulness of comparing the diversity of the applicant pool to the estimated availability in the labor pool. As discussed in Finding 1, we noted a promising measure at one campus as it states that it sends reminders to applicants when response rates are unreasonably low requesting that they complete and submit the forms containing their gender and ethnicity.

We have some additional concerns about the hiring of nonacademic management personnel. The campuses we reviewed generally lack a requirement that search committees review information in campus affirmative action plans when planning the hiring process and performing an analysis of applicant pool data to assess their success in recruiting women and minorities for nonacademic management personnel positions. We also noted inconsistent hiring practices between academic and nonacademic management personnel positions at one campus. This inconsistency further highlights the need for the chancellor's office to issue systemwide guidance on the hiring process for all management personnel.

Finally, we have concerns about the manner in which the campuses conduct their availability analyses for these positions. The campuses we reviewed consider management personnel at the administrator IV level as one group for purposes of their availability analysis. Because they do not separate the analysis for management personnel based on the functions of the positions, the analysis is not as meaningful as it could be. For instance, campuses could present the analysis separately based on position duties, such as those having responsibility for academic affairs or finance, because these positions typically draw from separate labor pools. Devising a meaningful analysis may assist campuses in better planning their search and recruitment efforts for management personnel.

We recommended that the university issue systemwide guidance on the hiring process for management personnel and in developing this guidance it should direct campuses to develop hiring policies for management personnel that address the key steps in the hiring process. Further, this guidance should include the development of alternatives for including women and minorities on search committees, the use of affirmative action plans so search committees are aware of the underrepresentation of women and minorities, a requirement to compare the proportion of women and minorities in the total applicant pool to the proportion in the labor pool to help assess the success of their outreach efforts, and the distribution of reminders to applicants requesting them to submit information regarding their gender and ethnicity. Additionally, we recommended that the university advise campuses to compare and report the gender and ethnicity of their current workforce to the labor pool by separating management personnel positions into groups based on the function of their positions to ensure goals are meaningful and useful to those involved in the hiring process.

University's Action: Pending.

The university indicated that chancellor's office staff will develop guidance indicating the basic principles that should be included in campus hiring policies for management personnel. Further, the university stated that it will include guidance to campuses on developing alternatives to broaden the perspective of search committees and increase the reach of the search for management personnel, having search committees review information in the affirmative action plans, using applicant pool data to assess the effectiveness of recruitment efforts, and identifying the appropriate levels for availability analyses. The university also stated that it will notify campus officials that they may send reminders to applicants regarding the submission of their gender and ethnicity, but that such reminders should clearly explain the use of the data collected and the applicants' rights to decline to submit such information. The university indicated that it will give careful consideration to whether any action or guidance could be viewed as an illegal "preference" in violation of Proposition 209.

Finding #5: Policies for hiring system executives are minimal and the consideration of diversity when hiring presidents and system executives is limited.

The chancellor alone is responsible for the search process for system executives; the policy governing this hiring process gives the chancellor discretion on how to conduct the search. According to the university's chief of staff, the board's policy provides the chancellor with this responsibility because the board believes the chancellor should have the ability to select his or her executive team. The search process for system executives must include representation from the board and advice from one or more presidents, faculty, and students chosen at the chancellor's discretion. For the one system executive hired during our audit period, the chancellor appointed a search committee whose responsibilities included screening and selecting applicants. However, without establishing more complete policies to guide the recruitment process for system executives, the university cannot ensure that the process for each search is fair, equitable, and consistent.

Further, the university policies for hiring presidents and system executives do not require consideration of gender and ethnicity during the hiring process. For instance, although professor positions are generally advertised in a variety of sources, including the Women in Higher Education and Hispanic Outlook, these same publications are not routinely used when advertising for presidential and system executive positions. According to the university's chief of staff, advertising is just one aspect of recruiting and that, in the experience of the chancellor's office, the best means to attract women and minority applicants is through direct personal contact, including that made by the chancellor, the chief of staff, or a third party such as a campus president. Nevertheless, the university could enhance the effectiveness of its current recruitment efforts by having a more broad-based and consistent advertising requirement for presidential and system executive positions. Further, the university's policies that govern the formation of the search committees involved in the search and selection process for presidential positions do not address gender and ethnic representation on such committees.

We recommended that the university establish more complete policies to guide the recruitment process for system executives to ensure that the process for each search is fair, equitable, and consistent. Further, to ensure it is conducting inclusive and consistent advertising to obtain as diverse an applicant pool as possible, the university should require broad-based advertising, including publications primarily with women or minority audiences, for all presidential and system executive positions. Finally, to broaden the perspective of the committees involved in the search for presidential positions, the university should develop policies regarding the diversity of these committees and consider alternatives to increase their diversity.

University's Action: Pending.

The university asserted that some improvement can be made in the existing system executive recruitment policies and procedures and stated that it will review them with the board and determine if specific changes should be made in light of our recommendations. Further, the university stated that while it is committed to improving its hiring process, it would give careful consideration to whether any changes could be viewed as an "illegal" preference in violation of Proposition 209.

Grade Separation Program

An Unchanged Budget and Project Allocation Levels Established More Than 30 Years Ago May Discourage Local Agencies From Taking Advantage of the Program

REPORT NUMBER 2007-106, SEPTEMBER 2007

California Department of Transportation's response as of November 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) perform an audit of the funding and approval process required for state and local transportation agencies for grade separation projects. Specifically, the audit committee asked the bureau to assess the roles and responsibilities of the various agencies involved in the funding and approval of grade separation projects to determine if any duplication of effort or program exists. Further, the audit committee requested that the bureau determine whether the Grade Separation Program is being administered and operated in accordance with the appropriate statutes and regulations, and that it identify any obstacles that state and local agencies face in meeting the program's legislative goals.

We also were asked to identify the funding sources for the Grade Separation Program and to determine whether the program uses the sources available and whether funding levels are reasonable and consistent with other comparable programs. The audit committee asked that we identify any changes in statutes that would improve the program's administration or any alternative funding mechanisms that could facilitate meeting its legislative goals. In addition, we were asked to determine which local agencies have received state funding for grade separation projects and, to the extent possible, to review estimated and actual costs for the projects. We also were asked to review a sample of these projects to determine the reasons for any cost overruns, the efforts local agencies made in planning and funding the projects, best practices available to local agencies to improve projections and control costs, and whether all local agencies face similar issues with projecting and controlling costs.

Audit Highlights . . .

Our review of the Grade Separation Program found that:

- *Although the average cost of a grade separation project has increased from \$2.5 million in 1974 to a current average of just more than \$26 million, the annual funding of \$15 million available for the Grade Separation Program has not changed since 1974.*
- *Local agencies say they are experiencing difficulties securing the funding necessary to pay for their share of grade separation projects; thus, some are not nominating new projects to be included on the Public Utilities Commission's (Commission) priority list and many are not applying for funds for the projects already on the priority list.*
- *A report prepared by the Commission in March 2007 showed that \$165 million is needed to provide funding for the same number of grade separation projects that \$15 million provided in 1974.*
- *Additional funding will be available for grade separation projects from a bond measure approved by California voters in November 2006, which will provide a one-time amount of \$250 million to improve railroad crossing safety.*
- *The California Department of Transportation does not always comply with state regulations when allocating supplemental funds to projects for which the final costs exceed the preliminary cost estimates.*

Finding #1: Local agencies believe allocations are not sufficient to allow them to take advantage of the Grade Separation Program.

Once they have nominated a grade separation project to the Public Utilities Commission (Commission) and the project has been placed on the Commission's priority list, many local agencies we surveyed are not taking the additional steps to apply to the California Department of Transportation (Caltrans) for funding under the Grade Separation Program. Many of these agencies indicated that they are not applying for this funding because they are having difficulty securing the funds to cover their portion of the costs of grade separation projects. We found that the portion of project costs that local agencies are expected to pay has increased dramatically over the past 30 years. According to data provided by the Commission, the average cost of a grade separation project increased from \$2.5 million in 1974 to more than \$26 million currently, while the annual budget of \$15 million for the Grade Separation Program has remained unchanged since 1974. A report prepared by the Commission showed that $165 million is needed to provide funding for the same number of grade separation projects as $15 million provided in 1974. However, some local agencies have been able to secure funding from other sources to pay for their projects without using funds from the Grade Separation Program. A recently approved bond measure will provide additional funding for grade separation projects. In addition to the proceeds from the bond measure, the State Transportation Improvement Program can also fund various local transportation projects including grade separation projects.

We recommended that in light of local agencies' limited participation in the Grade Separation Program, the Legislature should reconsider its intent for the program and the extent to which it wishes to continue assisting local agencies with their grade separation projects. Among possible courses of action, the Legislature could discontinue the program after the proceeds from the bond measure approved in November 2006 have been allocated and require local agencies to compete with a broader range of projects for funding available to them through other programs such as the State Transportation Improvement Program. Alternatively, the Legislature could continue the program and increase the annual budget of $15 million and allocation limits per project because it desires to continue providing a specific source of funding focused on grade separation projects.

Legislative Action: Unknown.

Finding #2: Caltrans does not always follow regulations when allocating supplemental funds, and some regulations are inconsistent with statutes.

We found that Caltrans does not always comply with state regulations when allocating supplemental funds to projects for which the final costs exceed the preliminary cost estimates. For example, four of the six applications we reviewed did not include one or more of the required certifications, and two were missing a statement explaining in detail why the original allocation was insufficient. Additionally, Caltrans' current regulations are inconsistent with statutes; thus, applicants may not be aware of changes in law and may either choose not to submit an application or submit inconsistent applications.

To ensure that it administers the Grade Separation Program in compliance with state regulations, we recommended that Caltrans follow state regulations when making supplemental allocations. Further, to be consistent with statute, it should seek to revise current regulations to conform to recent amendments to statute.

Caltrans' Action: Partial corrective action taken.

Caltrans stated it has developed a checklist to verify that requests for supplemental allocations include all of the documentation required by the California Code of Regulations. Further, Caltrans stated its Division of Rail has assigned one of its staff to take the lead in revising the regulations to conform to current statutes and is working with Caltrans' legal office on plans to implement the regulation amendments.

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

REPORT NUMBER 2005-135, JULY 2006

California Department of Transportation's response as of June 2007

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.

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.*
- *Caltrans did not report the solid waste generated on all its construction projects and often could not support the data it did report.*

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 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: Corrective action taken.

Through issuance of a construction policy bulletin, revisions to its construction manual, and development of a new recycling form, Caltrans has finalized guidance procedures for its district recycling coordinators to improve data collection and submission and to clarify reporting requirements. In addition, Caltrans has developed a training module for resident engineers on the updated procedures, which it plans to include in the resident engineers' winter 2007 training. Lastly, Caltrans noted that it will perform an evaluation in January 2008 to determine if its changes have improved the quantity and quality of its data collection and reporting.

The Carl Moyer Memorial Air Quality Standards Attainment Program

Improved Practices in Applicant Selection, Contracting, and Marketing Could Lead to More Cost-Effective Emission Reductions and Enhanced Operations

REPORT NUMBER 2006-115, JUNE 2007

State Air Resources Board and local air districts' responses as of December 2007

The Carl Moyer Memorial Air Quality Standards Attainment Program (Moyer Program) is an incentive program offered by the State Air Resources Board (state board) in conjunction with participating air pollution control districts and air quality management districts (collectively, local air districts). The Moyer Program provides funds to help private companies, public agencies, and individuals undertake projects to retrofit, repower, or replace existing engines to reduce pollution emissions beyond what is required by law or regulations. A local air district can fund a project that provides cost-effective emission reductions. Emission reductions are considered cost-effective when the cost to reduce 1 ton of emissions is at or below the cost ceiling imposed by the state board.

The Joint Legislative Audit Committee asked the Bureau of State Audits to review how the state board and key local air districts manage the Moyer Program. We limited our review to the four largest districts in terms of the Moyer Program funds they received—the Bay Area Air Quality Management District (Bay Area air district), Sacramento Metropolitan Air Quality Management District (Sacramento Metropolitan air district), San Joaquin Valley Unified Air Pollution Control District (San Joaquin Valley air district), and South Coast Air Quality Management District (South Coast air district). In addition to the findings and recommendations discussed below, we also examined the policies and procedures of the state board and the local air districts; the state board's use of liaisons to the local air districts and desk audits of reports from the local air districts to monitor their Moyer Programs; the high cancellation rate at one entity relative to others; the availability of Moyer Program funds to projects operating in multiple air districts; the project inspections local air districts conduct; monitoring of projects after they have been implemented; and the length of time it takes local air districts to move projects through the Moyer Program process. We found the following:

Audit Highlights . . .

Our review of the Carl Moyer Memorial Air Quality Standards Attainment Program (Moyer Program) revealed the following:

- ***California law impedes emission reductions by allowing the State Air Resources Board (state board) to set aside only 10 percent of Moyer Program funds for projects that operate in more than one local air district.***
- ***The methodology the state board used to select projects for the multidistrict component undervalues the cost per ton of intended emission reductions.***
- ***For fiscal year 2003–04, 14 of the 16 projects the Bay Area Air Quality Management District designated as matching projects exceeded the Moyer Program's ceiling for cost per ton of intended emission reductions.***
- ***The South Coast Air Quality Management District did not spend $24.1 million in Moyer Program funds within the required two years and the state board is monitoring the district to ensure these funds are spent by July 1, 2007.***
- ***We identified several best practices that, among other things, can help local air districts select projects with lower costs per ton of intended emission reductions.***

Finding #1: State law impedes maximum emission reductions.

California law impedes emission reductions by allowing the state board to set aside only 10 percent of Moyer Program funds for projects that operate in more than one local air district. A higher cap could lead to emission reductions with lower costs per ton. For example, if the cap for multidistrict projects were increased to 15 percent for funds appropriated in fiscal year 2004–05, the state board could have selected three additional projects with intended emission reductions costing an average of $2,600 per ton. Shifting this funding would have reduced the money available to districts, thus preventing the four districts we visited from selecting 13 projects. However, the average cost of the intended emission reductions from those projects was nearly $11,000 per ton, clearly not as good a value as the multidistrict projects.

We recommended the state board seek legislation to revise state law to increase the 10 percent maximum proportion it can allocate for multidistrict projects. If the state board opts not to seek this revision, the Legislature may wish to consider it.

Legislative Action: Legislation proposed.

Senate Bill 895, which would increase to 20 percent the maximum proportion the state board can allocate for multidistrict projects, was in the Senate Committee on Rules as of December 2007.

Finding #2: The methodology the state board uses to select projects has undervalued the cost-effectiveness of emission reductions.

Three of the six categories the state board uses to assign points when scoring applications for multidistrict projects are neither required nor encouraged by state law. Of the 100 possible points, these three categories accounted for 35 and 55 points, respectively, in the two fiscal years we reviewed. An applicant who received no points for any one of the three categories likely had limited ability to compete with other applicants under consideration. As a result, the state board selected some projects with higher costs per ton of intended emission reductions than it would have if the point values for the three optional categories were lower.

We recommended the state board, when evaluating applications for multidistrict projects, assign more points to scoring categories that help the state board achieve the lowest cost per ton of emission reductions.

State Board's Action: Pending.

According to the state board, it will increase the weight of the cost per ton of emission reductions when assessing projects in 2008. It told us that as of December 2007, it was still in the process of developing the scoring criteria. The state board plans to solicit project applications in early 2008 and select projects in spring 2008.

Finding #3: Some projects the Bay Area air district funded for matching purposes do not meet the Moyer Program requirements for cost-effective emission reductions.

State law requires local air districts to provide their own funds to match Moyer Program funds provided by the state board. Further, projects funded with these matching funds must meet all Moyer Program criteria. Our review revealed that projects funded by one local air district did not meet the Moyer Program requirements for cost per ton of intended emission reductions. As allowed by state law, the Bay Area air district designated 16 projects funded by other programs it administered as matching projects for the Moyer Program for fiscal year 2003–04. However, 14 of the 16 projects it identified exceeded the state board's cost ceiling of $13,600 per ton. The Bay Area air district knew the costs per ton for the projects it selected for matching exceeded the cost ceiling. Instead of selecting other eligible projects, the district attempted to make the 14 projects qualify as match under the Moyer Program by counting only a portion of the projects' total costs when it calculated the projects' costs per ton. Specifically, the district counted as the matching fund portion for the Moyer Program only $740,000 of the $2.5 million it awarded to these 14 projects. This approach is contrary to state law and Moyer Program guidelines because the district did not include all funds under its budgetary control when it calculated the costs per ton of intended emission reductions.

We recommended that local air districts include all funds under their budgetary authority as part of the calculations when determining the cost per ton of a project's intended emission reductions. Further, districts should develop and implement policies and procedures that enable them to meet the requirements in the Moyer Program guidelines regarding matching funds.

Bay Area Air District's Action: Partial corrective action taken.

The Bay Area air district stated that work is underway to recalculate the cost per ton of emission reductions for Moyer projects it has approved. It also stated that this recalculation will allow the district to reallocate matching funds if necessary. The district also plans to assess the cost-effectiveness of those projects designated as match beginning in January 2008. The Bay Area air district also states that it is in the process of reviewing and updating its procedures manual for the Moyer Program.

Finding #4: Unspent Moyer Program funds remained at local air districts after availability had expired.

State law requires that local air districts expend Moyer Program funds allocated by the state board by June 30 of the second year following the allocation; otherwise, the unexpended funds revert to the state board. As of December 2006 the South Coast air district had $24.1 million in Moyer Program funds it had not spent within the two-year time frame established by law. Unspent Moyer Program allocations are a strong indicator that intended emission reductions likely are not occurring. When allocating its fiscal year 2004–05 Moyer Program funds, the South Coast air district selected projects intended to reduce 1 ton of emissions for every $4,256 it spent, on average. Had the South Coast air district spent the $24.1 million on similarly cost-effective projects by the statutory deadline of June 30, 2006, 5,600 tons of pollutants would have been removed.

The South Coast air district interprets the word "expended," as it appears in state law, to mean obligated. Under that interpretation, as long as a local air district had obligated a specific amount of Moyer Program funds to pay for a project that will be completed in the future, unspent funds would not revert to the state board. However, both the state board and the Department of Finance (Finance) have criticized the South Coast air district for its lack of spending in audit reports issued in October 2006 and April 2007, respectively. It is clear that, within the context of their reports, both the state board and Finance expected the district to spend Moyer Program funds within the two-year availability period, not merely obligate them for projects.

The state board is withholding future Moyer Program allocations to the South Coast air district until it spends its expired funds. The state board noted that it has the district's assurance that it will fully expend all applicable Moyer Program funds by July 1, 2007. The state board is monitoring the district to ensure that this happens.

We recommended that the South Coast air district ensure that it spends by July 1, 2007, all remaining Moyer Program funds that are beyond the two-year availability period.

Also, to help ensure that the South Coast air district spends the allocations, the state board should continue monitoring the district's efforts and take appropriate action should its efforts falter. If the South Coast air district does not spend the funds by July 1, 2007, the state board should initiate appropriate administrative action, up to or including recovering all remaining unspent funds.

State Board's Action: Corrective action taken.

The state board reported that it continues to monitor the South Coast air district's expenditures through quarterly progress reports; the October 2007 progress report shows that the district is on track with the timely expenditure of funds. Further, the state board determined that, based on a June 2007 site visit, the South Coast air district had met its expenditure requirements. In addition to implementing these recommendations, the state board stated that it will update the Moyer

Program guidelines regarding consequences for local air districts should they fail to meet the two-year expenditure requirement. It plans to present the proposed revisions to board members at the March 2008 meeting.

South Coast Air District's Action: Corrective action taken.

See 'State Board's Action' above.

Finding #5: Infrequent on-site audits are a concern.

The state board may not be performing on-site audits of local air districts with sufficient frequency. It conducted four on-site audits in 2006 and plans to complete four more in 2007. If it maintains the rate of four audits per year, the state board will audit districts participating in the Moyer Program, on average, once every seven years. Audits released in 2006 demonstrate that some local air districts improperly administer the Moyer Program. More frequent audits would address identified problems earlier.

The state board is updating the procedures it uses to conduct on-site audits of local air districts, according to a program manager. These changes are based on findings from a 2006 review by Finance of the Moyer Program guidelines as well as feedback from the audited districts and from the state board's audit staff about the on-site audits it had already completed. In its report in December 2006, Finance made eight observations with recommendations for ways the state board could improve the Moyer Program guidelines and procedures, including a recommendation that the state board adopt a systematic, risk-based approach to selecting local air districts to audit. Finance also recommended 12 revisions to the guidelines to make the language clearer, define terms, and provide more detail.

We recommended that, to ensure that it monitors local air districts' implementation of the Moyer Program effectively, the state board continue to implement its planned changes to audit procedures and address the recommendations in Finance's 2006 audit report, including the development of a risk-based approach to selecting districts to audit. As part of this effort, the state board should consider how frequently it will audit districts.

State Board's Action: Partial corrective action taken.

According to the state board, it has taken several steps to improve its evaluation and audit procedures for local air districts; it has created a new oversight section, received approval to hire six new positions, and is close to fully staffing the new section. Also, the state board plans to audit seven local air districts in 2008, three more than it audited in 2007. To select the local air districts to be audited, the state board stated that it used a risk-based methodology developed in cooperation with Finance. Finally, the state board affirms that it has updated its policies and procedures for auditing the Moyer Program, in part to incorporate recommendations from Finance's report.

Finding #6: Although local air districts market the Moyer Program in various ways, they could do more to evaluate the results of their efforts.

Local air districts use various methods to market the Moyer Program, such as brochures, mailing lists, Web pages, and workshops, but they do not adequately evaluate their efforts to determine whether they are reaching the business sectors that might be able to provide more cost-effective emission reductions. The districts rely primarily on one measure—whether they receive enough applications to distribute all Moyer Program funds—to evaluate their marketing efforts. Thus, they cannot ensure that their marketing efforts are resulting in applications that help maximize cost-effective emission reductions.

We recommended that the local air districts develop and implement techniques to measure the effectiveness of their marketing methods. Specifically, local air districts should identify business sectors from which they will obtain applications for more cost-effective projects, evaluate whether their current marketing efforts are reaching those sectors, implement marketing efforts to target sectors not being reached, and assess whether their marketing efforts enable them to select projects with more cost-effective emission reductions.

Local Air Districts' Actions: Partial corrective action taken.

Two of the four local air districts included in our review are taking steps regarding this finding. The Bay Area air district states that it is starting a marketing study and will use cost per ton of emission reductions across various industries, business sectors, and locations to optimize its marketing, develop a marketing plan, and follow up with measures of success. The South Coast air district stated that it has entered into a contract with a company to complete this task and that the final report will include cost-effective marketing techniques that will generate desirable projects. On the other hand, the San Joaquin Valley air district acknowledged that as emission reductions become more expensive, it may be necessary to perform more targeted outreach while the Sacramento Metropolitan air district stated that, based on the results of a survey it conducted, it believes the best way to reach participants is to continue to provide a high level of customer support to applicants.

Finding #7: Timing requirements for preinspections can be overly restrictive.

Timing requirements for conducting preinspections—inspecting the engine to be retrofit, repowered, or replaced to ensure that it is still operational—are overly restrictive. The Moyer Program guidelines generally require local air districts to perform preinspections after the districts have awarded funds but before they execute the related contracts. One district chose not to follow this requirement because delaying the execution of the contract would have delayed project implementation.

We recommended that, to help streamline the process for performing preinspections, the state board revise its requirement that local air districts must perform preinspections before executing contracts.

State Board's Action: Partial corrective action taken.

The state board is proposing to amend its guidelines that require preinspections before executing contracts. Revisions to the guidelines are under development and the state board expects to present the proposed revisions to board members at a March 2008 meeting. The state board also stated that in the interim it is providing local air districts with flexibility regarding the timing of preinspections.

Finding #8: Local air districts use some best practices for contracting and administering Moyer Program funds.

During our visits to the state board and the four local air districts, we observed best practices that we believe can help districts select projects with lower costs per ton of intended emission reductions, reduce district workloads, and allow more time for project completion. Given the differences that exist among the districts, these practices may not be applicable in all cases. However, we believe they deserve serious consideration by the districts.

The Bay Area and South Coast air districts included a measure of pollution or the effects of pollution in their approaches for identifying disproportionately impacted communities—those communities with the most significant exposure to air contaminants, including communities of minority or low-income populations or both.

The state board included a measure of the cost per ton of emission reductions when selecting projects from disproportionately impacted communities for the multidistrict component of the Moyer Program, which increases the state board's ability to maximize emission reductions from multidistrict projects.

The Bay Area and Sacramento Metropolitan air districts include requirements in their contracts that projects selected from disproportionately impacted communities must continue to operate at least a specified percentage of their time in those communities after the project is completed and operational, which helps ensure that completed projects reduce emissions in disproportionately impacted communities.

The Sacramento Metropolitan air district uses only one application form for all its incentive programs, including the Moyer Program, which streamlines the application process for potential projects.

All but one of the four local air districts we visited had, by December 31, 2006, already allocated to projects their Moyer Program funds appropriated in fiscal year 2005–06, well ahead of the June 30, 2007, deadline. By making allocations before the deadline, these three districts allow more time for completing projects before the end of the two-year availability period.

Three local air districts issue one contract per project owner, as opposed to one contract per vehicle, which reduces the administrative burden on the districts.

The Bay Area and South Coast air districts included more detailed project milestones in their contracts, which allows the districts to more easily track the progress of their Moyer Program projects and take appropriate action if the projects veer off track.

The local air districts required projects to be completed before the statutory limit for expending funds, which helps districts ensure that they have sufficient time to perform required inspections and pay project owners before the two-year availability period for Moyer Program funds expires.

The Sacramento Metropolitan and San Joaquin Valley air districts delegated limited project approval and contract execution authority to staff of the local air districts, which may enable local air districts to issue contracts more quickly, thereby allowing more time for implementing projects before the end of the availability period.

The South Coast air district performed multiple inspections at the same time when possible. The district's staff found that this practice allowed them to save time and allowed the affected projects to move forward without unnecessary delay.

The South Coast and San Joaquin Valley air districts imposed stricter funding requirements on some projects, such as requiring certain types of projects to meet a lower threshold for cost per ton of emission reductions, or requiring project owners to pay a greater share of the costs. These practices could enable the districts to fund more projects with their Moyer Program dollars.

We recommended that, to improve their administration of the Moyer Program, local air districts consider implementing the following best practices:

- Include measures of pollution or the effects of pollution in their approaches for identifying disproportionately impacted communities.
- Include a measure for comparing the cost per ton of intended emission reductions when selecting projects from disproportionately impacted communities.
- Include in their contracts the requirement that projects selected from disproportionately impacted communities continue to provide benefits from reduced emissions to those communities after implementation.
- Use a single application for their Moyer Program application process.

- Allocate Moyer Program funds to applicants as soon as possible.
- Implement a system of one contract per project owner.
- Include in their contracts specific milestones against which the project owners and local air district staff can measure the progress of their projects.
- Include in their contracts the requirement that project owners complete projects and submit invoices a specific number of days or weeks before the June 30 deadline.
- Obtain delegated authority from their governing boards to approve Moyer Program projects and execute contracts. If their governing boards are not comfortable in providing delegated authority to approve all Moyer Program projects, obtain delegated authority to approve the more routine projects or projects costing less than a specified amount.
- Conduct consolidated preinspections to the extent practicable.
- Impose stricter standards (for example, caps on individual contract amounts or lower costs per ton of intended emission reductions) on project categories to the extent that such action does not reduce involvement in the Moyer Program.

Local Air Districts' Actions: Partial corrective action taken.

The four local air districts we reviewed have considered the best practices we identified. In many instances, the air districts have implemented or are implementing many of the best practices we identified. For instance, three of the four air districts report they have implemented the best practice of using one contract per project owner while the fourth is exploring whether to implement it. However, the air districts also indicate that some best practices are not practicable for them. Regarding our best practice that districts include in their contracts requirements that projects selected from disproportionately impacted communities continue to provide benefits to those communities after implementation, the South Coast air district states that upon review by its legal counsel, it does not believe it is possible to incorporate language in its contracts that requires continued use of equipment in a specific location.

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

REPORT NUMBER 2005-034, JUNE 2006

Board of Equalization's response as of June 2007

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:

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.***
- ***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.***

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.

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

[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.

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 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

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.

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: Corrective action taken.

Equalization reported that its new calculation of cigarette tax evasion resulted in an estimated $182 million of lost excise taxes per year, which is a decrease of $88 million per year from its previous estimate. Equalization stated that its use of an updated econometric model allowed it to use more recent data and consider the estimated combined effects of the implementation of the act and the new cigarette tax stamp.

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.

Medical Board of California's Physician Diversion Program

While Making Recent Improvements, Inconsistent Monitoring of Participants and Inadequate Oversight of Its Service Providers Continue to Hamper Its Ability to Protect the Public

REPORT NUMBER 2006-116R, JUNE 2007

State and Consumer Services Agency's response as of December 2007

The Joint Legislative Audit Committee requested the Bureau of State Audits review the effectiveness and efficiency of the Medical Board of California's (medical board) Physician Diversion Program (diversion program). In our review, we found that although the diversion program had made many improvements since the release of the November 2005 report of an independent reviewer, known as the enforcement monitor, there were still some areas in which the program needed to improve in order to adequately protect the public. For instance, although case managers appeared to be contacting participants on a regular basis and participants generally appeared to be attending group meetings and completing the required amount of drug tests, the diversion program did not adequately ensure that it received required monitoring reports from its participants' treatment providers and work-site monitors.

In addition, although the diversion program had reduced the amount of time it takes to admit new participants into the program and begin drug testing, it did not always respond to potential relapses in a timely and adequate manner. Specifically, the diversion program did not always require a physician to immediately stop practicing medicine after testing positive for alcohol or a nonprescribed or prohibited drug. Further, of the drug tests scheduled in June and October 2006, 26 percent were not performed as randomly scheduled. Additionally, the diversion program did not have an effective process for reconciling its scheduled drug tests with the actual drug tests performed and did not formally evaluate its collectors, group facilitators, and diversion evaluation committee members to determine whether they were meeting program standards. Finally, the medical board, which is charged with overseeing the diversion program, had not provided consistently effective oversight.

Medical Board's Action: Discontinued the diversion program.

In July 2007 the medical board met and determined that it would allow the diversion program to sunset on June 30, 2008. Due to the termination of the program, the medical board did not address individual audit report recommendations in its responses to the audit. Rather, the medical board described its transition plan, which was approved by the board in November 2007. Key components of the plan are outlined on the following pages:

Audit Highlights . . .

Our review of the Medical Board of California's (medical board) Physician Diversion Program (diversion program) revealed the following:

- *Case managers are contacting participants on a regular basis and participants appear to be attending group meetings and completing drug tests, as required.*
- *The diversion program does not adequately ensure that it receives required monitoring reports from its participants' treatment providers and work-site monitors.*
- *The diversion program has reduced the amount of time it takes to bring new participants into the program and begin drug testing, but the timeliness of testing falls short of its goal.*
- *The diversion program has not always required a physician to immediately stop practicing medicine after testing positive for alcohol or a nonprescribed or prohibited drug, thus putting the public's safety at risk.*
- *Twenty-six percent of drug tests in June and October 2006 were not performed as randomly scheduled.*
- *The diversion program's current process for reconciling its scheduled drug tests with the actual drug tests performed needs to be improved.*

continued on next page . . .

» *The diversion program has not been formally evaluating its collectors, group facilitators, and diversion committee members to determine how well they are meeting program standards.*

» *The medical board has not provided consistently effective oversight of the diversion program.*

Self-referred participants:

- The diversion program will no longer admit new, self-referred physicians into the program.
- Self-referred participants with three years of sobriety will be referred to a Diversion Evaluation Committee (DEC) for a determination of whether the individuals can be deemed to have completed the program.
- On June 30, 2008, self-referred participants with less than three years of sobriety will be sent a letter stating that the diversion program is inoperative and encouraging the physicians to find another monitoring or treatment program.

Board-referred participants:

- The medical board will notify individuals seeking admission into the diversion program in lieu of disciplinary action (board-referred) that the program will be inoperative June 30, 2008, and, at that time the medical board will refer the individuals to the Attorney General's Office and enforcement for further action. Being made fully aware of this condition, participants will be given the choice of entering the program or proceeding through the enforcement process.
- Current, board-referred participants with three years of sobriety will be referred to a DEC for a determination of whether the individuals can be deemed to have completed the program.
- On January 1, 2008, board-referred participants with less than three years of sobriety will be sent a letter stating that the diversion program will be inoperative as of June 30, 2008, and that they must find another program that meets the protocols of the diversion program. In addition, the other program must be willing to report to the Medical Board's chief of enforcement on a regular basis and to immediately notify the board of any positive drug tests.

Board-ordered participants:

- The medical board will no longer approve a stipulation that requires participation in the diversion program as a condition of a disciplinary order or issuance of a probationary license.
- On July 1, 2008, the diversion program condition in all disciplinary orders will become null and void and will no longer be considered a condition of probation. However, individuals will still be required to abstain from drugs and alcohol and must submit to drug testing. Staff will continue to monitor the random drug tests of these individuals.

Out-of-state participants:

Staff will continue to liaison with programs in other states to ensure that out-of-state participants comply with that respective state's program until completion.

Department of Social Services

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

REPORT NUMBER 2005-129, MAY 2006

Department of Social Services' responses as of May and August 2007

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.

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.*

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. The department stated its feasibility study related to the plan has been approved but that implementation of the plan is dependent upon funding. In the meantime, 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 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. According to the department, the results of the review showed that the majority of the information provided to it involved descriptions of policies, procedures, opinions, and recommendations. The department reported that empirical studies are scarce showing the effects of such policies, procedures, and recommendations on the health and safety of children. Although the department stated that information presented in the UCD report did not lend itself to comparison with practices in the State such as frequency of visits, it further stated its belief that the State appears to meet many of the standards that informed opinion considers to be beneficial in protecting the health and safety of children in child care. These standards include well-defined licensing requirements, background checks, and staff training and education requirements.

The department also reported that it intends to develop the necessary tools and management information to better assess its oversight responsibilities through its information technology strategic plan. (See Finding 1 for further discussion.) In addition, it stated that it accepted the recommendations of its performance review team about the use of data from one of its automated systems to facilitate quality reviews. The department further reported that its work team is identifying automated system information for use as quick performance indicators, developing procedures for electronic review of work, and designing formats for ongoing management reports to serve as routine performance indicators. Finally, the department stated its development and implementation of a web-based application to enhance public access to information 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 implemented a new standard procedure in which monthly it identifies complaints that are pending over 90 days and makes a plan for their completion and closure. In addition, the department stated that it continued to review data on the findings of complaint investigations and found that about 30 percent were inconclusive. The department stated that it is making modifications to its system to obtain more specific complaint data by regional office. The department also stated it will continue to study ways to reduce the number of inconclusive findings. Further, the department stated that all staff in its child care program have been trained in all facets of complaint investigations, including determining accurate findings. Moreover, in response to its pilot project regarding the timing of supervisory approval, the department issued a memo to standardize the process for reviewing and approving complaint investigations before the plan of correction has been issued. Finally, the department reported that it completed its complaint specialist pilot project and is in the process of incorporating pilot project practices into its permanent method of investigating serious complaints. However, the department encountered recruitment and retention issues among its complaint specialists and, as of August 2007, was soon to submit a request for a pay differential for these positions to the Department of Personnel Administration to address the issues.

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: Corrective action taken.

The department developed extensive revisions to its evaluator manual, particularly regarding clearing deficiencies, granting extensions for plans of correction, and using self-certifications. The evaluator manual revisions also included guidelines for developing effective plans of correction. In addition, the department indicated that it trained its staff in these areas and that there has been an increase in supervisory involvement to ensure consistency.

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: 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. Additionally, the department issued memos and distributed a civil penalty manual about the requirement and use of civil penalties as well as developed enhancements to the evaluator manual to further clarify the use of civil penalties. Further, the department concluded that the requirement is appropriate for follow-up visits to be made within 10 days of the plan of correction date in order for civil penalties to be assessed. Finally, the department stated that it may use progressive civil penalties to bring a licensee into compliance in the event that a follow-up visit is not made within 10 days.

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 license 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.

As of its latest response in August 2007, the department was in the process of revising the evaluator manual to incorporate the directives from its May 2004 memorandum and the recommendations from its internal review team.

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: Corrective action taken.

The department reported that the legal division's early consultation pilot project in Southern California was well received, yet significant operational changes were made because of staff turnover. It reevaluated areas of assignment and sent legal staff to regional offices to be readily available for consultation. However, the department stated that it was doubtful it would expand the pilot project to Northern California, in part because the diversion of legal counsel to full-time consultation did not seem likely. Still, the department stated that it has continued to stress the need for early legal consultation. Finally, the department indicated that it requires monthly legal consultation on all cases that may result in an administrative action.

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 issued a memo in October 2006 that directed all licensing staff to consider follow-up visits to facilities with revoked licenses or those with excluded individuals as the highest priority work, equal to complaint visits. The memo also addressed instructions for ensuring that a facility is actually closed when revocation becomes effective, ensuring that an excluded person has actually left the facility, and monitoring visits to facilities on probation. In addition, the department indicated that it requested additional resources to minimize the impact on other licensing and monitoring activities. Further, the department stated that it was revising its evaluator manual to incorporate the mandates of the memo. Finally, the department stressed the importance of making enhancements to allow for automated tracking and notification for follow-up visits to facilities.

California Institute for Regenerative Medicine

It Has a Strategic Plan, but It Needs to Finish Developing Grant-Related Policies and Continue Strengthening Management Controls to Ensure Policy Compliance and Cost Containment

REPORT NUMBER 2006-108, FEBRUARY 2007

California Institute for Regenerative Medicine's response as of September and December 2007

In 2004 voters approved the California Stem Cell research and Cures Act (act), which authorized the issuance of $3 billion in bonds over 10 years to fund a stem cell research program and dedicated research facilities in California. The act established the California Institute for Regenerative Medicine (institute) as a state agency with the purpose of funding stem cell research activities. The goal of the research is to realize therapies, protocols, and medical procedures that, as soon as possible, will lead to curing or substantially mitigating diseases and injuries. To oversee the institute's operations, the act established the Independent Citizens Oversight Committee (committee).

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the implementation of the act and the performance of the institute and the committee to the extent that the program is operating. The audit committee asked us to review and evaluate the strategic plan and related policies developed by the institute and the committee. In addition, the audit committee asked us to review and evaluate certain institute policies and procedures and related management controls to determine whether they are necessary and designed to carry out the intent of the act as well as other applicable laws and regulations, and to review the internal oversight structure of the institute and the committee.

Finding #1: The institute has developed a detailed strategic plan but lacks a process to use annual grantee data as a strategic monitoring tool.

During its December 2006 meeting, the committee adopted the institute's strategic plan. The plan outlines the goals and objectives in spending $3 billion in general obligation bonds authorized by the act and provides a strategy that strives to meet its purpose and intent. Our review revealed that the institute's strategic plan contains essential elements, including a mission statement and goals to achieve the mission. Many of the institute's goals depend on scientific discovery, creating the challenge of ensuring that they are achievable. However, the goals outlined in the strategic plan are specific in nature and were adopted unanimously by the committee. Our review also concluded that the institute's strategic plan clearly identifies its approach to achieving the scientific goals through an action plan for the first 1,000 days, as well as performance mechanisms and milestones to ensure accountability, assess performance, and gauge scientific progress at years three and seven of the 10-year strategic plan.

Audit Highlights . . .

Our review of the California Institute for Regenerative Medicine (institute) revealed the following:

- *The institute identified long-term research priorities and considered the industry's best practices to create its strategic plan, but it has yet to implement a process to assess annual progress toward attaining its strategic goals.*
- *A task force formulated draft policies for revenue sharing through a public deliberative process but, because of a lack of documentation, we could not independently evaluate any analyses of the information on which the task force members based their revenue-sharing policies.*
- *Although it has a grants administration policy for academic and nonprofit institutions, the institute is still developing a for-profit policy and is still implementing a monitoring process to ensure that grantees comply with the terms of their grants.*
- *The institute's recent policy revisions addressed our contracting concerns, but not all of our travel reimbursement concerns.*
- *The salary survey conducted by the institute and the compilation of the salary data collected contained enough errors, omissions, and inconsistencies that the institute cannot ensure that the salaries for certain positions comply with the requirements of the law.*

However, the institute has not yet developed and implemented the process to accumulate the annual grant-specific data it plans to use to gauge its progress in meeting strategic goals. The institute's plan indicates that one source of data that performance assessment will rely on are the grantee reports of their progress in meeting the purpose of their respective grants. Institute grantees have annual financial and programmatic reporting requirements specified in the interim grants administration policy they are to follow. However, as of December 2006 the institute had no mechanism to track management information to assess yearly progress toward its strategic goals, and its staff informed us that they are developing such a mechanism to be part of a planned integrated information technology system. The system would allow the institute to pull data from the annual progress reports submitted by grantees, which already are required by the grants administration policy, thereby enabling the institute to monitor various types of information, including progress toward strategic goals and initiatives. The institute also stated it is determining what information grantees must submit with their annual progress reports.

We recommended that the institute fulfill its plans to develop a process to track management information reported annually by grantees, thereby providing accountability and enabling it to assess annual progress in meeting its strategic goals and initiatives.

Institute's Action: Partial corrective action taken.

At the October 3, 2007, committee meeting, the institute presented the grants management system software and services provider recommended by institute staff and the process staff used to select the provider. The committee granted the institute approval to contract with the provider for a grants management system.

Finding #2: The committee has not completed provisions of its intellectual property policies regarding discounted prices and access to therapies.

The committee's intellectual property policy for nonprofit organizations requires that grantees award exclusive licenses involving institute-funded therapies and diagnostics only to entities that agree to have a plan to provide access to those therapies and diagnostics for uninsured Californians. However, the policy does not define what is meant by access. The committee could not agree on the language to refine this provision, but because the committee did not want to delay implementing its regulations regarding intellectual property developed for grants to nonprofit organizations, it took no action to amend the policy and regulations.

In addition, the for-profit policy requires every grantee to develop a plan to provide uninsured Californians with access to therapies that result from institute-funded research. However, as with the nonprofit policy, the for-profit policy does not define its expectation for access. According to the transcripts of the December 2006 committee meeting, the task force established by the committee to create the policies deliberately did not include specific requirements for an access plan. According to the vice chair, it is difficult to specify what should be in a plan for access to future products. As such, the task force believes that most companies working in areas of great concern to public health do end up with plans for access, and that those plans differ from one company to the next. Without a clear definition or expectation of access, however, grantee organizations will be left to apply their own interpretations.

Further, the intellectual property policies for nonprofit entities and for-profit entities do not describe how prices will be discounted for therapies that result from institute-funded research. During the December 2006 committee meeting, the vice chair explained that the task force had difficulty finding practical benchmarks for the lowest available prices. He further stated that the portions of the policies for both nonprofit entities and for-profit entities that address discounted prices for therapies are works in progress. The committee agreed that once a practical benchmark is identified, it will apply the benchmark as a standard for discounted prices for therapies resulting from institute-funded research to the policies for both nonprofit and for-profit organizations.

We recommended that the committee ensure that it follows through with its plan to identify the appropriate standard for providing uninsured Californians access to therapies developed using institute funds and to convey clearly to grantees its expectations for providing access in its intellectual property policies. In addition, the committee should identify practical benchmarks to use as a standard for discount prices for therapies and apply the standard to its policies for grants to nonprofit and for-profit organizations.

Institute's Action: Partial corrective action taken.

The institute reports that it remains committed to ensuring that therapies developed through institute-funded research projects are accessible to uninsured patients and discounted prices for California patients whose drugs and non-drug therapies are purchased with public funds. The institute states that it held public meetings to allow interested parties to review and consider relevant regulatory issues and standards in both issues and is continuing to develop the appropriate regulations governing both nonprofit and for-profit grantees.

Finding #3: A provision of the institute's intellectual property policy allowing researchers access to institute-funded inventions warrants further attention.

The intellectual property policy for nonprofits initially included a research use exemption (research exemption) provision that sought to ensure that patented inventions made in the performance of institute-funded research be made freely available for research purposes in California research institutions. The provision was eliminated from the nonprofit policy in the July 2006 meeting of the task force after some members expressed concern over industry opposition to the research exemption provision. The committee's vice chair stated at the meeting that industry representatives expressed concerns that a research exemption might decrease investment if they could not take patented inventions under license from universities and exploit those patents to make them profitable.

In the August 2006 task force meeting, a modified research exemption was reintroduced for consideration in the nonprofit policy after new information from universities expressed that not having a research exemption had been a problem. However, the new language of the research exemption still received considerable objection from industry representatives. As a consequence, the task force agreed on compromise language. The compromise language states that in licensing institute-funded patented inventions, a grantee organization agrees that it shall retain the rights to institute-funded patented inventions for its noncommercial purposes and agrees to make such inventions readily available on reasonable terms to other grantee organizations for noncommercial purposes. Although concerns were raised over whether including the phrase "reasonable terms" was good regulatory language and over who would decide what are reasonable terms, the task force adopted the language. Although the effect of the language on advancing stem cell research is not yet known, we believe that this area warrants continued monitoring by the committee.

We recommended that the committee monitor the effectiveness of its policy to make institute-funded patented inventions readily accessible on reasonable terms to other grantee organizations for noncommercial purposes to ensure that it does not inhibit the advance of stem cell research.

Institute's Action: Pending.

As part of its grants management process, the institute states that it will monitor compliance with its regulations regarding access to institute-funded patented inventions by requiring grantees to submit annual reports that identify licensed patented inventions, as well as any requests for access by other scientists for noncommercial research purposes.

Finding #4: The institute is still developing a policy for administering grants to for-profit entities.

Although the committee has adopted a policy to review applications for and administer research grants to nonprofit entities, it has not yet adopted a similar policy regarding for-profit entities. According to the institute's director of scientific activities, the nonprofit policy was created before the for-profit one because the institute anticipates that most of the fundamental research will be conducted by nonprofit organizations and because it believes that information on grants administration policy is more readily available for nonprofit entities than for profit-making organizations. In addition, the grants review working group and the institute intend to use the nonprofit grants administration policy as a template for the for-profit policy. According to the director of scientific activities, as of early January 2007, the institute was at the early stages of developing the for-profit policy and was therefore unable to predict how long the process would take.

We recommended that the institute complete the development of its grants administration policy targeted toward for-profit organizations.

Institute's Action: Partial corrective action taken.

The institute began drafting a grants administration policy targeted toward for-profit organizations in December 2006 and held meetings for interested parties in fall 2007 to discuss issues related to the policy. The proposed policy was included in the agenda for the December 12, 2007, committee meeting for its consideration.

Finding #5: The grants review working group substantially followed its policy when it reviewed training grants, but it lacked voting records.

Our review of the institute's available records indicated that the institute, its grants review working group, and the committee substantially followed the grants review and award processes during the review and award of training grants. However, we found that the institute did not maintain records of the grants review working group's votes on grant applications. As a result, we could not conclude that the grants review working group complied fully with the nonprofit grants administration policy. After we shared our concerns with the institute, it developed new procedures designed to ensure that every voting action is recorded. As of December 2006 the only grants the institute had awarded were training grants, which are designed to help pay the costs of the stem cell research activities of pre- and postdoctorate students and clinical fellows in California's universities and nonprofit academic and research institutions.

To provide increased accountability over the grants award process, we recommended that the institute ensure that the grants review working group follows the new procedures to record its votes to recommend funding for stem cell research grants, and that it maintains those records.

Institute's Action: Corrective action taken.

In 2006 the institute developed new procedures designed to ensure every voting action is recorded. Shortly after, it implemented those procedures during its grants working group meetings held during November 28 through November 30, 2006, and January 8 through January 10, 2007. The institute now retains these records as part of its documentation of the grant award process.

Finding #6: The institute is developing procedures to ensure that grantees comply with the terms of the awards.

Although the committee has approved a policy for administering nonprofit grants, the institute still is developing procedures to monitor grantees' compliance with the terms of the grants. For example, the act requires the grants review working group to conduct oversight reviews of grantees and to recommend standards to the committee to ensure that grantees comply with the terms of awards. Although the grants review working group and the institute, through the nonprofit grants administration policy, developed these standards, the institute has not yet implemented a strategy to conduct the reviews.

The institute intends to conduct reviews of grantees through annual financial and programmatic reports mandated by the nonprofit grant administration policy. Failure to submit the reports promptly may result in the reduction, delay, or suspension of a grant award. However, as of December 2006 the institute had not completed the format of the financial and programmatic reports.

In addition, the institute reserves the right to conduct audits, but it has not yet established systematic audit procedures because it still is implementing the grants monitoring process, of which the audit procedures will be a part. In addition, the institute has not yet fully assembled a team to administer the financial aspect of the grants. As of early December 2006 the institute still had substantial work to do in developing procedures pertaining to the grants monitoring process, and the director of scientific activities did not know when these procedures would be complete. However, until the institute and the working group put in place the procedures and team members to monitor grantees' compliance with the terms of the grants, the institute runs the risk that grant funds will not be used for their intended purpose.

To monitor the performance of grantees effectively, we recommended that the institute complete the implementation of a grants monitoring process, including audits, and the development of related procedures.

Institute's Action: Partial corrective action taken.

The institute's grants administration policy for nonprofit organizations requires an administrative review prior to issuing a formal notice of grant award and before funds are released. According to the institute, for research grants it has developed a coding system to monitor the types of research that it funds. For facilities grants, the institute's interim grants administration policy states that requests for grant applications will detail the milestones and amounts for progress payments. The institute states that it continues to develop a web-based reporting system for grantees to facilitate the grants monitoring process.

Finding #7: The Fair Political Practices Commission has questioned the exclusion of the working groups from the institute's conflict-of-interest code.

The Political Reform Act requires that the institute submit its conflict-of-interest code to the Fair Political Practices Commission (FPPC) for review and approval. The FPPC must review the code to determine if it provides reasonable assurance that all foreseeable conflicts of interest will be disclosed or prevented, all affected persons have clear and specific statements of their duties under the code, and the code differentiates between designated employees with different powers and responsibilities. The institute submitted its code to the FPPC in July 2005, and after an exchange of correspondence between the FPPC and the institute, the FPPC approved the institute's code in May 2006. Subsequent to FPPC approval, the institute submitted the conflict-of-interest code to the Office of Administrative Law for its review and inclusion in state regulations. The Office of Administrative Law approved the institute's code in September 2006.

However, the FPPC has raised questions about the exclusion of the working groups from the institute's conflict-of-interest code. The FPPC believes that members of working groups, who perform duties such as advising the committee on standards and policy or evaluating grant applications and making award recommendations to the committee, may need to be included in the conflict-of-interest code. Specifically, the FPPC believes that, under state regulations, working group members may act as decision makers if they make substantive recommendations that are, over an extended period, regularly approved without significant amendment or modification by the committee.

In response to the FPPC, the institute stated that members of the working groups are not subject to the pertinent requirements because the language in the institute's act expressly exempts those members from the Political Reform Act, even when the recommendations of a working group are approved over an extended period. Therefore, according to the institute, it is not necessary to engage in ongoing analysis to determine whether, over time, the committee routinely approves the working groups' recommendations.

The FPPC responded that the language of the act is no basis for exempting working group members from fundamental disclosure rules if it becomes apparent that the members' role is more than purely advisory. As such, the FPPC concluded that this issue may need to be revisited in the future.

In view of the seriousness of a violation of the conflict-of-interest laws and the concerns raised by the FPPC, we believe that it would benefit the institute to seek a formal opinion from the attorney general regarding the matter.

We recommended that the institute seek a formal opinion from the attorney general regarding whether the exemptions created for working groups from conflict-of-interest laws are intended to exempt them from the conflict-of-interest provisions that apply if the recommendations of an advisory body are adopted routinely and regularly by the decision-making body to which they are made.

Institute's Action: None.

➲ The institute states that it has given careful consideration to our recommendation and has decided that it is not appropriate to implement it at this time. The institute states that in almost three years of operation and approval of four rounds of grants, the committee has never routinely or regularly adopted the recommendations of the institute's working groups. Until the time that such a pattern is detected, the institute believes the question we raise is hypothetical and not appropriate for submission to the attorney general. However, the institute states that it will continue to monitor the committee approvals for such a pattern and will reconsider our recommendation if such a pattern emerges.

Finding #8: The institute had not included in its conflict-of-interest policy provisions for specialists it might enlist to assist in evaluating grant applications.

Although, during our review, the institute implemented some improvements in its conflict-of-interest policies, it had not yet amended its policy for working groups to include specialists it might enlist to assist in evaluating grant applications. The institute recruited 32 out-of-state specialists in November 2006 to assist in reviewing innovation grant applications because it believed that the number of reviewers, which the act limits to 15, is not large enough for the number of grant applications it received. In the future, the institute intends to use specialists as needed. Specialists are individuals with scientific expertise on a particular issue who do not have a voting privilege and whose presence is not counted toward a quorum. According to the director of scientific activities, they are contacted through teleconference during the review meeting, act as secondary reviewers, and do not score or vote on any application. The institute's process is for specialists to disclose conflicts of interest before the review meeting and file confidential financial disclosure statements. When we made the institute aware that these specialists were not addressed in the conflict-of-interest policy for the grants review working group, it agreed to propose an amendment that it intended to present to the committee at its February 2007 meeting.

We recommended that the institute follow its plans to amend its conflict-of-interest policies to include specialists invited to participate in stem cell research program activities, such as grant application review.

Institute's Action: Corrective action taken.

In March 2007 the committee adopted a change in the conflict-of-interest policy for the grants working group to include specialists.

Finding #9: Institute employees may not have the information they need to comply with the conflict-of-interest policy.

The institute's conflict-of-interest policy prohibits institute employees from having more than $10,000 of financial interests in any organization that is applying for funding with the institute. However, the institute has not developed procedures to inform its employees of the organizations that apply for grants. According to the institute, such notification has not been necessary because, as of December 2006, all grants were awarded to nonprofit institutions, which do not have shareholders or other investors. However, the institute reports that it will advise its employees of the identity of the applicants when it starts issuing requests for applications to for-profit organizations.

To provide employees with the information they need to disclose all potential conflicts of interest, we recommended that the institute develop the necessary procedures to ensure that its employees are aware of the companies that apply for funding.

Institute's Action: Corrective action taken.

The institute's conflict-of-interest procedure for institute employees now incorporates a mechanism that identifies all entities that have applied for funding pursuant to a particular request for applications. Employees are to review a list of applicants to note any conflicts and disqualify themselves from reviewing any application with which they may have a conflict of interest.

Finding #10: The institute could improve steps to detect conflicts of interest before meetings of the grants review working group.

The institute's procedures to avoid conflicts of interest in grants review working group activities require it to review the confidential financial interest disclosure statements of noncommittee members of the working group, but not the Statements of Economic Interest of the committee members of the working group. Therefore, the institute could overlook a conflict of interest. After we shared our concern with the institute, it agreed in December 2006 to revise its procedures to require a review of Statements of Economic Interest to identify potential conflicts of interest before each grants review meeting. Our examination of the Statements of Economic Interest revealed nothing to indicate such a conflict of interest existed during the review of training grants in August 2005—the only grants awarded at the time of our review.

In addition, the institute's incomplete records of the activities related to the meetings of August 2005 to review training grants do not clearly demonstrate its efforts to follow its procedures and ensure that no conflicts of interest existed. The institute compiles a recusal list—a list of members of the grants review working group who should be disqualified from reviewing, scoring, and voting on certain grants with which they have a conflict of interest—based on its study of reviewers' published articles and the disclosures that working group members make before the grants review meetings. We found that data explaining why certain members were added and removed from the recusal list during the review meeting were lost.

The director of scientific activities stated that the institute gathered data, some of which dealt with past collaborations of reviewers, but destroyed it to maintain the confidentiality of the grants review process, as is the practice at the National Institutes of Health—the federal agency on which the institute modeled its conflict-of-interest policies related to reviewing grants. Lacking the necessary data, we were not able to ensure the accuracy of the recusal list the institute used to determine which grants review working group members had to recuse themselves during the review of training grants. This is problematic because we found that the sheets reviewers used to score applications had three unexplained differences from the institute's recusal list, one of which indicates that a reviewer scored an application on which he may have had a conflict of interest. The director of scientific activities believes her personal records of the meetings would show that the reviewer did not have a conflict of interest with respect to the application he scored; however, she has not been able to locate her personal records since the institute moved to its current location in November 2005.

To ensure compliance with its conflict-of-interest policies, we recommended that the institute revise its procedures for reviewing grants to include a review of the Statements of Economic Interest for committee members of the working groups before every grants review meeting. Moreover, we recommended it revise its procedures for grants review meetings to ensure that it retains documentation regarding conflicts of interest of the working groups, including information that it took appropriate recusal actions.

Institute's Action: Corrective action taken.

The institute's current procedures to identify conflicts of interest of members of the grants working group include staff review of their conflict-of-interest disclosures prior to each meeting. The institute further reports that it now documents the recusal actions of each member with respect to each application reviewed to ensure that no one participating in the review of a particular application has a conflict of interest. The institute reports that it maintains these records.

Finding #11: The institute's contracting policy and travel reimbursement policy did not provide adequate controls.

The institute did not establish a contracting policy effectively ensuring that it received appropriate goods and services at reasonable prices. Based on language in the act, legal counsel for the institute concluded that it is governed by all the provisions of the Public Contract Code that affect the University of California (UC). Additionally, it is the institute's intent to model its policies substantially after those of UC. However, much of the institute's policy, including provisions related to hiring consultants, procuring goods and services, and awarding sole source contracts, did not conform to UC policy. As a result, the institute awarded multiple contracts without a competitive-bidding process and did not maintain documents that demonstrated it received reasonable prices on the goods and services it purchased. In response to our concerns about contracting, in December 2006 the institute revised its procurement policy to mirror the UC policy, thereby addressing our concerns. In addition, the institute has indicated to us that it is developing an internal procedures manual that will have more-detailed requirements for the contractor selection process.

In addition, the institute's travel reimbursement policy did not provide sufficient control over travel expenses. The institute originally adopted the travel reimbursement policy of the Department of Personnel Administration, but then revised the policy several times to conform more closely to the UC policy, but with certain deviations. In general, the revisions allowed travelers greater flexibility and more liberal reimbursements. For example, the institute removed maximum reimbursable amounts for some expenses, such as meals for committee meetings. The revisions also made the policy confusing because they did not use consistent language, and some new provisions did not specify whether they replaced or supplemented existing policies. For instance, the policy contained multiple reimbursement rates for items such as meals but failed to provide clear guidance on when to use each rate. Moreover, the institute reimbursed costs for air travel and meals without sufficient documentation of travel expenses to ensure that its policies were followed.

In response to our concerns over travel reimbursements, the institute revised its travel reimbursement policy in December 2006. However, the revised policy did not address all of our concerns. For example, the institute did not revise the form that working group members use to claim travel reimbursement to include information specific enough to allow institute staff to properly review the claims to ensure reimbursement policies for meals are followed. Moreover, the revised policy specifies that it applies only to institute staff and working group members, not to members of the committee. The committee chair stated that the committee will consider amendments to the travel policy in the upcoming months.

To ensure adequate controls over its contracting and travel reimbursements, we recommended that the institute ensure that it follows its newly revised policies that address some of the concerns raised in our audit. The institute also should amend its travel reimbursement policies further to address the remaining concerns we raised.

Institute's Action: Partial corrective action taken.

The institute reports that under its policy and practice, employees are not reimbursed for meals at meetings where meals are provided without prior authorization. The institute reports that it monitors the travel claims of staff who attend meetings to ensure that reimbursement is not claimed when the institute provides a meal.

The institute states that as of March 1, 2007, it uses the standard state travel claim form to process claims for all members of working groups. The institute reviews and allows these claims in accordance with the same policy and procedure applicable to institute employees.

On April 5, 2007, the committee's governance subcommittee adopted a recommendation to the full committee that it adopt for its members the policies and procedures for travel for institute staff and working group members. The committee did not adopt the policy for its members in its April 10, 2007, meeting. However, according to the institute in September 2007, the committee chair has asked that reimbursements to committee members conform to the proposed policy, assuming adoption in October or December 2007.

Finding #12: The institute's salary survey and salary-setting process did not ensure compliance with the act.

The act states that the committee must set compensation for the chair and vice chair of the committee and the president, officers, and staff of the institute within the compensation levels of specified categories of public and private universities and private research institutes in the State. The institute conducted a salary survey that included not only the entities specified in the act but other entities as well in an attempt to ensure that the established salary levels would be in compliance with the act and justifiable to public inquiries.

We noted that the committee and the institute thoughtfully considered the originally approved salary schedules, and for some positions reduced the salaries from those derived from the survey data. However, because of errors, omissions, and inconsistencies in the survey and in the compilation of the salary data collected, the committee and the institute cannot be certain that all salaries comply with the act's requirements. The institute substantially agrees with our assessment of its salary-setting activities and stated it will conduct another survey to identify the appropriate comparable positions to use to set the salaries for 11 positions.

To ensure that the methodology to set salary ranges complies with the act, we recommended that the institute follow through with its plan to resurvey any positions whose salary ranges were affected by the errors, omissions, and inconsistencies in its initial salary survey and salary-setting activities.

Institute's Action: Partial corrective action taken.

The institute reports that it has hired Mercer Human Resources Consulting to review and survey all institute salaries and, as of September 2007, expected a report within the next few weeks that will be discussed with the committee.

Department of Health Care Services

Investigations of Improper Activities by State Employees, July 2006 Through January 2007

INVESTIGATION I2006-0731 (REPORT I2007-1), MARCH 2007

Investigative Highlight . . .

An employee at the Department of Health Care Services received an inappropriate credit of 241.5 hours to his leave balance for compensated time off, representing a potential overpayment of $7,453.

Department of Health Care Services' response as of November 2007

We investigated and substantiated an allegation that an employee of the Department of Health Care Services (Health Care Services)[1] improperly received overtime payments.

Finding: The employee violated regulations covering travel expense reimbursements and payment of commuting expenses when he failed to subtract his commute from the total work time he claimed over a four-month period.

The employee, a fraud investigator, failed to subtract his normal round-trip commute time from the total work time he claimed each day during the four-month period he was at a training academy. The employee attended a training academy from mid-August 2005 through mid-December 2005. During this period, he claimed three hours of overtime for each day he attended the training academy, which represented the travel time from his residence to the training academy and back to his residence. Although the State's collective bargaining agreement with the union allows employees to claim travel time as overtime under certain circumstances, state regulations provide that decisions relating to reimbursement for travel expenses be made based on the best interest of the State. In addition, federal regulations specify that an employer who reimburses an employee for travel expenses related to a special assignment in a different location may subtract the employee's regular commute time from the total time claimed.

The employee indicated that other Health Care Services' investigators who previously attended the academy told him that it was common practice for attendees to receive compensation for all their travel time to and from the academy. His supervisor stated that although he was not aware of any law, rule, or regulation permitting investigators attending the training academy to claim overtime for their travel time, he claimed it was standard practice for investigators to claim overtime for their travel time.

As a result of failing to subtract his normal commute time from the total work time he claimed each day, the employee received an inappropriate credit to his leave balances of 241.5 hours of compensating time off to which he was not entitled, representing a potential overpayment of $7,453.

[1] As of July 1, 2007, the California Department of Health Services was reorganized. Current day-to-day operations will continue under the new Department of Health Care Services or the California Department of Public Health.

Health Care Services' Action: Partial corrective action taken.

In its initial response, Health Care Services disagreed with the finding of our investigation. It believes we did not consider that the employee is a peace officer, which requires that he respond to urgent or emergency calls outside scheduled working hours. Further, Health Care Services stated that the employee does not commute to or from a field location or headquarters. Because Health Care Services did not believe the employee's activity was improper, it stated that it would not be taking any action against him or his supervisor.

Subsequently, Health Care Services noted that it plans to examine the future use of overtime in connection with investigator participation in the training academy, specifically the use of overtime in lieu of per diem to ensure that the decision is made in the best interest of the State. In addition, it concurs with the Bureau of State Audits' observation regarding the manner in which overtime hours should be calculated. Therefore, Health Care Services stated that it would no longer include normal commute time of investigators in its determination of approved overtime hours when overtime in lieu of per diem is used.

Department of Health Services

It Needs to Improve Its Application and Referral Processes When Enrolling Medi-Cal Providers

REPORT NUMBER 2006-110, APRIL 2007

Department of Health Services' response as of October 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Department of Health Services'[1] (department) provider application and referral processes for California's Medical Assistance Program (Medi-Cal). Specifically, we were asked to compare the department's enrollment and application procedures to those used by the federal Medicare program and to determine whether any information is shared between the two programs during the enrollment process. Additionally, we were asked to determine whether the department tracks and monitors the average time it takes to review a physician application and to identify the number of full-time staff assigned to review these applications. The audit committee asked us to identify the number of applications denied over the past year and the reasons for the denials. Further, we were asked to review the department's procedures for handling deficient applications and to determine when it notifies applicants about deficiencies. The audit committee requested us to identify the number of applications referred for further review in the past year, including the reason for the referral and the number that were denied. Finally, we were asked to identify the number of applicants requesting preferred provider status in the past year, the total number of applicants awaiting enrollment into the Medi-Cal program, and the number of applications the department did not process within the designated review period.

Finding #1: The department did not process some applications within required time periods, and inaccurate data in its data system continue to hinder its ability to track application status.

In July 2000 the department established the Provider Enrollment Branch (branch) whose primary function has been to review applications and to prevent providers with fraudulent intent from participating in the Medi-Cal program. Although required by law to process applications and notify applicants of its final determination within specific time periods, the branch continues to review some after the end of the required processing period and is forced to automatically enroll other applicants into Medi-Cal, on provisional status, because it cannot make a timely determination on the application. In fact, for the period October 1, 2005, through September 30, 2006 (federal fiscal year 2006), the branch did not process 108 applications within the required time periods. Of these, it automatically enrolled eight applicants into the program on provisional status as required but did not automatically enroll or appropriately notify the remaining 100. When the branch does not automatically enroll applicants into the program when required, or promptly process applications and notify applicants of its final determination, it may prevent or delay some eligible providers from delivering services to Medi-Cal beneficiaries.

[1] Effective July 1, 2007, the California Department of Health Services reorganized to form the California Department of Health Care Services.

Audit Highlights . . .

Our review of the Department of Health Services' (department) provider application and referral processes for California's Medical Assistance Program (Medi-Cal) found that:

- ***Because of recent policy and administrative changes, the department's Provider Enrollment Branch (branch) has seen a decrease in the number of applications it receives; however, the branch does not process some applications within the time periods specified in statute.***
- ***Branch staff continue to enter data incorrectly into the Provider Enrollment Tracking System (PETS), decreasing the branch's ability to track the status of applications effectively.***
- ***Some applicants resubmit information to remedy their deficient applications soon after the required time period lapses, and state law requires the branch to deny these applications and treat them as new, preventing some eligible providers from offering services as soon as they otherwise could.***
- ***Given that few applicants request preferred provider status and the branch's current low average time to process an application, the status offers applicants few benefits.***
- ***The branch does not adequately track which of the department's review units it refers applications to or the reasons for these referrals.***

continued on next page . . .

» ***State law does not prescribe a required number of days in which the branch must approve or deny referred applications, and we noted that the department takes an inordinate length of time to process referred applications.***

» ***Because physicians applying to become providers in Medi-Cal and Medicare are asked to provide much of the same information, and the federal government is beginning two initiatives to ensure that more accurate and updated information is available about Medicare providers, the department may be able to streamline its application process by relying on some of Medicare's data in the near future.***

Further, the applications of seven of the eight automatically enrolled applicants had been recommended for denial and sent to the branch's policy and administrative section (policy section), which generally reviews all denied applications. However, their applications remained in the policy section after their respective due dates for completing processing had passed. Because the branch does not track the length of time applications recommended for denial remain in its policy section, it automatically enrolled these ineligible providers. Although these applicants can be removed from the Medi-Cal program while on provisional status, they may submit claims for services provided from the date the branch received their application to the date of their termination from the program. The department has the authority to recover payments made to ineligible providers, but it incurs additional costs when it must do so for providers whose applications should have been denied during the enrollment process.

Despite concerns we raised in a May 2002 audit regarding whether branch staff were entering data accurately and consistently into the branch's Provider Enrollment Tracking System (PETS), we noted that branch staff continue to enter data incorrectly, decreasing the branch's ability to effectively track the status of applications. For instance, branch management does not perform secondary reviews of the dates branch staff enter into PETS, such as the dates applications were received, returned to the applicant, or processed by the branch. Inaccuracies in these dates prevent the branch from effectively tracking the status of applications. Further, we noted that PETS contains 166 fictitious provider records, created as the result of staff training and branch testing of PETS that were commingled with production data.

We recommended that the branch notify applicants that it has automatically enrolled them as provisional Medi-Cal providers when it has not processed the applications within the required time periods. The branch should also modify PETS to track the length of time applications it recommends for denial remain in its policy section for review to ensure that it does not automatically enroll or pay the claims of ineligible providers when the review does not occur in a timely manner. Additionally, the branch should include in management's secondary review of applications periodic reviews to ensure that staff are accurately and consistently entering into PETS the correct dates the branch received, processed, or returned the applications. Moreover, the branch should remove all staff training and branch testing data from PETS and include it in an environment that simulates PETS, thus protecting the integrity of the production data.

Department's Action: Partial corrective action taken.

The branch reports that it has developed a letter and implemented a process to immediately notify applicants who have been automatically enrolled. Further, the branch states that it is in the process of updating its procedure manual with formal written procedures regarding the immediate notification of applicants who have been automatically enrolled. In addition, the branch states that it has modified the PETS and created a policy denial report and will soon have the ability to track applications referred to the policy section. Further, the branch reports that managers are currently monitoring staff work to ensure that staff are accurately entering dates into PETS and asserts that formal procedures are scheduled for completion in mid-October, with updates to its procedure manual scheduled shortly thereafter. Finally, the branch states that the training and testing data was removed from PETS in August 2007.

Finding #2: Many applicants do not resubmit corrected applications on time, which is the leading reason for denials.

Although the branch generally notifies applicants in a timely manner that their applications are deficient, applicants often fail to correct deficiencies within the required 35-day time period, or do not resubmit their corrected applications at all. This failure is the leading reason for denied applications. In comparison, the federal Medicare program allows applicants to remedy their deficient applications by submitting additional information within a 60-day time frame—25 days longer than Medi-Cal's time frame. To determine whether applicants who missed the 35-day deadline would have met the 60-day deadline, we calculated the number of applications that were resubmitted to the branch between 11 and 25 days after the 35-day time period during federal fiscal year 2006 (we allotted an additional 10 days for mail delays). According to PETS data, 258 applications were resubmitted within this time frame and, therefore, treated as new applications subject to the 180-day processing period—of which the branch ultimately approved 126. Had state law authorized the branch to process applications that were resubmitted within a 60-day time frame rather than a new 180-day time frame, a greater number of eligible providers could have provided services to beneficiaries sooner than they otherwise did.

Moreover, the branch could do a better job of informing applicants that one of the leading reasons for denial is submitting an outdated or inappropriate application form. More than 20 percent of applicants were denied during federal fiscal year 2006 for this reason. When the branch does not adequately notify applicants that using outdated or inappropriate application forms will result in denial of application packages, it increases the number of applications it must process and ultimately deny and increases the length of time before some eligible providers can be enrolled in the Medi-Cal program. In turn, this may limit some beneficiaries' access to Medi-Cal providers.

We recommended that the department seek legislation to revise state law to extend the 35-day time period applicants have to remedy deficiencies in their applications. Additionally, the branch should increase its efforts to notify applicants that they must use current and appropriate application forms to avoid being denied enrollment into Medi-Cal.

Department's Action: Corrective action taken.

Chapter 693, Statutes of 2007, effective January 1, 2008, was signed by the governor on October 14, 2007, and extends the former 35-day time period applicants had to remedy deficiencies in their applications to 60 days. Additionally, the branch has updated the Medi-Cal Web site to provide notification to applicants that they must use the current and appropriate forms to avoid being denied enrollment into the Medi-Cal program and has updated the *Top Reasons Provider Enrollment Applications are Denied* to include this information.

Finding #3: Preferred provider status offers few benefits to applicants.

State law allows certain applicants to apply for preferred provider status, however, the only benefit to an applicant of qualifying for this status is that the branch must process the application within 90 days instead of 180 days. According to PETS, only 4 percent of the applications the branch received in federal fiscal year 2006 requested preferred provider status and, given that the branch's average time to process an application in September 2006 was just 30 days, the 90-day processing period appears irrelevant. Because the benefits to applicants appear to be marginal, we question the value of the status.

Additionally, the branch denied preferred provider status to more than half of the 60 applications we reviewed because the applicants submitted application packages that were incomplete or did not contain the required documents. Thus, to the extent that the department chooses to keep this status, it appears the branch should increase its efforts to convey to prospective applicants that their application packages will be denied if they are lacking certain elements. Consequently, the branch could see an increase in the number of applicants that could benefit from the shorter processing period that preferred provider status offers.

We recommended that the department seek legislation to revise state law to eliminate preferred provider status. If it chooses to keep this status and to increase the number of applicants that could benefit from the shorter processing period that preferred provider status offers, the department should increase its efforts to notify applicants of the reasons it denies applications during the prescreening for preferred provider status.

Department's Action: Corrective action taken.

The department asserts that while the majority of physicians have elected not to enroll under preferred provider status, the California Medical Association's intent for introducing the status under Senate Bill 857 remains valid. Thus, the department recommends allowing physicians to weigh the cost/benefit of enrolling as preferred providers. To promote awareness of preferred provider status, the branch posted a bulletin to its Web site describing how physicians can request, and provide documentation and verification for, consideration for enrollment in the Medi-Cal program as a preferred provider. Additionally, the branch indicates that it plans to update the *Top Reasons Provider Enrollment Applications are Denied* on its Web site to include the reasons preferred provider applications are denied in the prescreening process. Further, Chapter 693, Statutes of 2007 reduces from 90 days to 60 days the time within which the branch must notify applicants of the reasons it denies applications during the prescreening for preferred provider status. The branch reports that the shorter processing period may encourage qualified providers to apply for preferred provider status.

Finding #4: The branch does not track referral information adequately and the department takes an inordinate amount of time to process some applications that the branch refers.

Although the branch is authorized to conduct additional reviews by referring application packages to other units within the department, as well as to staff within the branch itself, it does not adequately track the reason for the referrals. For example, the reasons that branch staff may select in PETS for referring applications are vague and in some cases are problematic. In fact, nearly one-half of the applications that the branch referred in federal fiscal year 2006 lack a specific reason for the referral. This prevents the branch from contributing to the department's Medi-Cal fraud prevention efforts on an ongoing basis, because it is unable to accurately detect and track potential trends in fraud during the enrollment process.

Further, state law does not prescribe a required number of days within which the branch must approve or deny an application it has referred for further review, and we noted that referred applications take an inordinate length of time to process. For instance, in federal fiscal years 2004 and 2005, PETS indicates the average number of days to process applications that the branch referred was 322 and 255 days, respectively. Referred applications that were processed in federal fiscal year 2006, including those referred in prior years, remained in the enrollment process for an average of 318 days. According to PETS, of the applicants among this group that were ultimately approved or denied (rather than being in process or returned to the applicant as deficient or for other reasons), the branch approved 69 percent as Medi-Cal providers, in one case taking up to 1,007 days, thus preventing one eligible Medi-Cal provider from providing services to Medi-Cal beneficiaries for nearly three years.

Additionally, the branch and the Medical Review Branch within the department's Audits and Investigations division do little to coordinate with each other to identify and update the branch's high-risk fraud indicators or to formally track the status of referred applications. In fact, in the past six months the branch has not held its regular meeting with the Medical Review Branch, which served to foster information sharing between the two branches in a more formal setting than the occasional communication they may currently have regarding certain applications. To the extent that the branch's high-risk indicators are no longer current and do not align with the reasons for referral available in PETS, its ability to track the legitimate reasons it has for referring applications is hindered, decreasing the branch's capability to detect potential fraud trends during the enrollment process.

We recommended that the branch coordinate with the department to update PETS to reflect the specific reasons that it refers applications for further review, so that they are aligned with its fraud indicators and high-risk review checklist. Further, to ensure it is referring those applicants at greatest risk of committing fraud and not preventing eligible Medi-Cal providers from providing services to beneficiaries, the branch and the Medical Review Branch, with direction from the department, should reevaluate the appropriateness of the branch's high-risk fraud indicators periodically by consistently communicating and collaborating with one another. Finally, with direction from the department, the branch and the Medical Review Branch should place increased emphasis on processing those applications referred for further review within a reasonable time period, to ensure that some eligible Medi-Cal providers are not unreasonably delayed from providing services to beneficiaries.

Department's Action: Partial corrective action taken.

The branch reports that it is working collaboratively with the Medical Review Branch to evaluate the fraud indicator checklists on a quarterly basis using findings from the ongoing risk assessment analyses and the annual Medi-Cal Payment Error Study. The branch states that it established a workgroup, consisting of branch and Medical Review Branch staff, which has reviewed the current list of high-risk indicators and identified changes that need to be made to PETS. The branch reports that the next phase will entail updating the reasons applications are referred in the PETS to accurately reflect the referral indicators, which it asserts will be completed by November 1, 2007. Finally, the branch indicates that new procedures will be finalized and implemented by mid-October to ensure that applications referred for comprehensive review are processed within 60 days of receipt of the onsite report from the Medical Review Branch.

Finding #5: The department may be able to streamline its application process for physicians by relying more on Medicare data.

Because applicants seeking to become physician providers in Medi-Cal and the federal Medicare program are asked to provide much of the same information in their application packages, the department may have the opportunity to streamline some of its enrollment processes for Medi-Cal applicants who are already Medicare providers by relying more on Medicare provider information in the near future. The federal government is beginning two initiatives intended to ensure that more accurate and updated information is available about Medicare providers. Specifically, effective November 15, 2006, federal regulations require Medicare providers to resubmit and recertify the accuracy of their enrollment information every five years in order to maintain their billing privileges. In addition, effective May 23, 2007, federal regulations require all health care providers who bill for services to disclose their National Provider Identifier (NPI) to any entity, when requested, to identify themselves as such.[2] Thus, the department can request applicants to provide their NPI on its Medi-Cal provider application, which it plans to do beginning late May 2007. Consequently, for those physician applicants it identifies as being in good standing with Medicare, the department may be able to rely on some of Medicare's data instead of performing redundant procedures to verify the same information. Although it is too early to determine

[2] According to the summary text of the Standard Unique Health Identifier for Health Care Providers final rule by the U.S. Department of Health and Human Services as published in the *Federal Register*, the NPI is a unique identifier for health care providers that will improve the Medicare and Medicaid programs in part by enabling the efficient electronic transmission of health care provider data.

the effectiveness of these two initiatives, it could be worthwhile for the department to periodically assess Medicare's progress and the benefits the department could derive from this centralized source of information.

We recommended that the branch monitor the implementation of Medicare's revalidation process in which it verifies the enrollment information for all of its providers to identify opportunities for streamlining its application and verification procedures, and make modifications as appropriate for Medicare providers seeking enrollment in the Medi-Cal program. Further, the branch should continue its plans to reenroll—a process in which the branch requires existing providers to submit new applications to ensure that they are suitable to continue participating in the Medi-Cal program—all of its Medi-Cal providers and add any resources freed by its streamlining of its enrollment process.

Department's Action: Partial corrective action taken.

The branch indicates that it continues to monitor Medicare's implementation of its revalidation process to identify opportunities for streamlining its application and verification procedures as appropriate, with a specific focus on the implementation of Medicare's federal regulations governing its accreditation and competitive bidding process for furnishing durable medical equipment, prosthetics, orthotics, and medical supplies. Further, the branch reports that it is nearing completion of four reenrollment phases of physicians, physician groups, and optometrists in Los Angeles County. The branch states that it continues to evaluate workload and available staff resources in carrying out reenrollment efforts.

Department of Mental Health, Coalinga State Hospital

Investigations of Improper Activities by State Employees, February 2007 Through June 2007

INVESTIGATION I2006-1099 (REPORT I2007-2), SEPTEMBER 2007

Investigative Highlight . . .

The Department of Mental Health misused state funds designated to purchase two law enforcement vehicles by using the vehicles for non-law enforcement purposes.

Department of Mental Health's response as of December 2007

We investigated and substantiated the allegation that the Department of Mental Health (Mental Health) violated provisions of state law that require a state agency to justify its need to purchase motor vehicles and to receive prior approval for the purchase from the Department of General Services (General Services).

Finding: Mental Health misused and wasted state funds by purchasing law enforcement vehicles and using them for non-law enforcement purposes, failed to maintain accurate home-storage permits, and failed to maintain required mileage logs.

In seeking approval from General Services, Mental Health indicated that it intended to use two 2005 Ford Crown Victoria Police Interceptors (Police Interceptors) for law enforcement purposes. However, after it received approval and purchased the vehicles, the Coalinga State Hospital (hospital) misused state funds and violated state law when it assigned the Police Interceptors first to its general motor pool and later to three hospital officials, who used them for non-law enforcement purposes including commuting. General Services indicated that it would not have approved the purchases of the Police Interceptors had it known how they would be used.

Additionally, we found that the purchase of the Police Interceptors was wasteful because Mental Health paid between $18,682 and $19,640 more to purchase the two Police Interceptors than it would have for two light-class sedans.

Also in violation of a state regulation, the hospital did not accurately list the officials' addresses on home-storage permits, thus failing to disclose that two of the officials used the Police Interceptors to commute between 390 and 980 miles per week. Further, the three hospital officials did not maintain the required mileage logs for the Police Interceptors they drove.

Mental Health's Action: Partial corrective action taken.

Mental Health stated that hospital management erred when it assigned the vehicles to the motor pool and subsequently to the officials who were not entitled to use law enforcement vehicles. It reported that hospital officials are now assigned light-class vehicles for business use only. It further reported that the hospital intended to transfer the two Police Interceptors to another Mental Health hospital until the hospital needs them. However, in December 2007 Mental Health still had not transferred the two Police Interceptors to another Mental Health hospital.

Regarding the home-storage permits and the vehicle mileage logs, Mental Health stated that the long commutes to the officials' "home" residences were inappropriate. It also reported that all home-storage permits are now accurate. Further, Mental Health reported that as of June 2007 all hospital employees who are assigned vehicles are maintaining vehicle mileage logs and that hospital motor pool staff are maintaining mileage logs for pool vehicles.

Finally, Mental Health reported that two of the officials have retired and that the remaining official was transferred to another hospital.

Department of Health Services

Investigations of Improper Activities by State Employees, February 2007 Through June 2007

INVESTIGATION I2006-1012 (REPORT I2007-2), SEPTEMBER 2007

Department of Health Services' response as of December 2007

We asked the Department of Health Services (Health Services) to assist us with the investigation, and we substantiated that an employee at Health Services misused state time, resources, and facilities for personal purposes that were inconsistent with the performance of his duties.[1] In addition, Health Services found other misuses of state resources.

Investigative Highlight . . .

An employee at the Department of Health Services used a state computer for personal purposes, including uploading modeling photos of a spouse.

Finding #1: The employee inappropriately used his state computer for personal benefit and entered a state building for nonwork-related reasons.

The employee accessed Internet sites on several occasions from July 2006 through October 2006 that were inappropriate. Specifically, Internet monitoring reports showed the employee visited modeling Web sites and Internet-based e-mail sites during the employee's regular weekday work schedule and on six nonbusiness days, such as weekends and holidays. In addition, Health Services found that the employee had no permission to enter the building on any of the six nonbusiness days. Moreover, on one weekend day, the employee's spouse accompanied him into the building. Health Services also determined that on nine days—eight of which were workdays—the employee spent more than three hours each day accessing the Internet, including viewing some modeling Web sites where his spouse had profiles and photos posted. Finally, Health Services found that, on one weekend day, the employee uploaded modeling photos of his spouse.

Health Services' Action: Partial corrective action taken.

Health Services reported that it initiated content filtering of Internet sites, making certain sites—such as modeling Web sites and Internet-based e-mail—inaccessible to its employees. It further stated that it modified the employee's building access to normal business days and hours only and suspended his Internet access.

When we reported the results of the investigation in September 2007, Health Services told us that it was pursuing adverse action against the employee but it appears that the status of the adverse action was inaccurate. Specifically, in December 2007 Health Services reported to us that the employee left in April 2007 before it completed its adverse action against him.

[1] The employee worked in a division of Health Services during the period of investigation. Health Services reorganized effective July 1, 2007. The employee's division is now within the Department of Public Health.

More importantly, Health Services told us that prior to the employee's departure, it did not document in his personnel file the specific circumstances or events leading to its investigation of the employee's misuse of state time and resources. The employee is now employed at another department. As a result, we are concerned that the other department is unaware of the employee's misuse of state time and resources.

Finding #2: The employee misused state resources.

The employee inappropriately used his state e-mail account to send or receive 370 e-mails that were not work related. Specifically, the employee sent and received 113 e-mails that related to his pursuit of modeling assignments for his spouse, with many of the e-mails containing images of his spouse that were not appropriate in the workplace. The remaining 257 e-mails related to the employee's attempt to sell telecommunications services for an outside company and other personal activities.

Health Services' Action: Corrective action taken.

Health Services suspended the employee's e-mail access in February 2007. However, as we stated previously, the employee left Health Services in April 2007 and, prior to his departure, it did not document in his personnel file the specific circumstances or events leading to its investigation of the employee's misuse of state time and resources.

Nonprofit Hospitals

Inconsistent Data Obscure the Economic Value of Their Benefit to Communities, and the Franchise Tax Board Could More Closely Monitor Their Tax-Exempt Status

REPORT NUMBER 2007-107, DECEMBER 2007

Board of Equalization's, Franchise Tax Board's, and Office of Statewide Health Planning and Development's responses as of December 2007

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits to conduct an audit to ascertain whether the activities performed by hospitals that are exempt from paying taxes because of their nonprofit status truly qualify as allowable activities consistent with their exempt purpose. Specifically, the audit committee requested that we determine the roles of the entities involved in determining tax exemptions and the extent of oversight they exercise over nonprofit hospitals to ensure that they comply with requirements for tax exemption and community benefit reporting. It also asked us to examine the financial reports and any community benefit documents prepared during the last five years by a sample of both nonprofit hospitals and hospitals that operate on a for-profit basis and determine the value and type of community benefits and uncompensated care provided. In addition, the audit committee asked us to compare the community benefits provided by nonprofit and for-profit hospitals, and compare the types of care that both types of hospitals provide without receiving compensation (uncompensated care). Further, the audit committee asked us to review the financial information and the claims submitted to the State Board of Equalization (Equalization) or other agencies by nonprofit hospitals to determine whether they meet income requirements to qualify for tax-exempt status and to assess how tax-exempt nonprofit hospitals use excess income, to ensure that the uses are permissible and reasonable in terms of expansion of plant and facilities, additions to operating reserve, and the timing of debt retirement. The audit committee also asked us to determine the most current estimated total annual value of the taxation exemptions of both state corporation income taxes (income taxes) and local property taxes for nonprofit hospitals.

Finally, the audit committee asked us to determine whether the community benefits and uncompensated care provided by nonprofit hospitals meet the requirements for exemption from local property and state income tax. However, although state law outlines the requirements a nonprofit hospital must meet to receive an exemption from paying taxes, it does not specify community benefits and uncompensated-care costs as requirements. Additionally, although state law requires most tax-exempt hospitals to annually submit to the Office of Statewide Health Planning and Development (Health Planning) a community benefits plan (plan), which may include an uncompensated-care element, the law also clearly states that the information included in the plan a nonprofit hospital submits cannot be used to justify its tax-exempt status.

Audit Highlights . . .

Our review of tax-exempt hospitals revealed the following:

- » *About 223 of California's 344 hospitals are eligible for income and property tax exemptions because they are organized and operated for nonprofit purposes.*
- » *Comparing financial data reported by nonprofit and for-profit hospitals indicated the uncompensated care provided by the two types of hospitals was not significantly different.*
- » *Benefits provided to the community, which only nonprofit hospitals are required to report, differentiate nonprofit hospitals from for-profit hospitals, but the categories of services and the associated economic value are not consistently reported among nonprofit hospitals.*
- » *The values of tax-exempt buildings and contents owned by nonprofit hospitals are frequently misreported by county assessors.*
- » *Lacking more reliable data, we used the reported economic values of community benefits and tax-exempt property to estimate that reported community benefits of $656 million for 2005 were roughly 2.7 times the estimated $242 million in state corporation income taxes and property taxes not collected from nonprofit hospitals.*
- » *The Franchise Tax Board, which administers state income tax exemptions, could better use available tools, such as annual filings and audits, to monitor the continuing eligibility of nonprofit hospitals for their tax exemption.*

Finding #1: Lack of specific guidance regarding the content of community benefit plans precludes any meaningful comparison of the plans.

Although state law requires that tax-exempt hospitals submit plans to Health Planning, it does not require Health Planning to review the plans to ensure that hospitals report the same types of data consistently, nor does Health Planning do so. Further, the law provides only limited guidance regarding the content of the plan and does not mandate a uniform reporting standard. Thus, in reviewing the plans that eight tax-exempt hospitals submitted from 2002 through 2006, we found significant variations in the plans that precluded us from performing any meaningful comparison of the economic values the hospitals reported. Although the guidance provided in the law does not require uniform reporting, two hospital associations offer hospitals some guidelines. Additionally, the Internal Revenue Services (IRS) is proposing a new schedule for hospitals to prepare to be included with the informational return that all income-tax-exempt organizations must file. If adopted, the IRS anticipates using the new schedule for the 2008 tax year. The new schedule will require tax-exempt hospitals to report their community benefits and uncompensated-care costs and could influence hospitals to pattern their plans after the schedule's methodologies and format.

We recommended that if the Legislature expects plans to contain comparable and consistent data, it consider enacting statutory requirements that prescribe a mandatory format and methodology for tax-exempt nonprofit hospitals to follow when presenting community benefits in their plans. We also recommended that if the Legislature intends that the exemptions from income and property taxes granted to nonprofit hospitals should be based on hospitals providing a certain level of community benefits, it consider amending state law to include such requirements.

Legislative Action: Unknown.

Finding #2: Errors in reported property values reduce the reliability of estimated property taxes not paid by tax-exempt hospitals.

We attempted to estimate the amount of property taxes not collected from tax-exempt hospitals, using the values of the buildings and contents owned by tax-exempt hospitals that county assessors submitted on statistical reports to Equalization. Although we found numerous errors in the values that prevented us from ensuring the reliability of our calculation, this methodology resulted in an estimated $184 million in uncollected property taxes in 2005. More specifically, we found errors in the reported values for four of the 12 hospitals we reviewed, representing a total error of about $204 million. The errors for the remaining 211 nonprofit hospitals in the State that are eligible for tax exemption are unknown. Equalization performs surveys of county assessors to determine the adequacy of the procedures and practices they apply in valuing property for the purpose of taxation and for administering property tax exemptions.

To ensure that it provides accurate information regarding the value that is tax exempt, we recommended that Equalization consider including in its surveys of the county tax assessors a process for verifying the accuracy of the values reported on the annual statistical reports submitted by the county assessors.

Equalization's Action: Pending.

Equalization indicated in its response to the audit report that it plans to incorporate steps in its survey review of county tax assessors to verify proper classification of exempted property based upon the type of organization within the welfare exemption. It also stated that this will provide more accurate reporting of exempted values by hospitals.

Finding #3: Recent legislation affects the Franchise Tax Board's responsibilities for granting income tax exemptions.

We found minor weaknesses in the process the Franchise Tax Board (tax board) used in the past to determine the eligibility of nonprofit hospitals for state income tax exemptions. However, legislation effective January 1, 2008, will allow the tax board to rely on the federal income tax exemptions determined by the IRS. Although it was unable to obtain IRS reports and other information on the federal review process and thus could not gain a full understanding of the method the IRS uses to determine eligibility for tax exemptions, the tax board contended that its research of the IRS web site, publications, and tax law enabled it to conclude that the IRS process is sufficient to ensure proper determination of state exemption status. The tax board also stated that because state and federal laws on tax exemption are essentially identical, the additional audits it plans to perform—made possible by the workload reduction resulting from its use of IRS eligibility determinations—will compensate for any differences in quality between the state and federal review processes. The tax board indicated, however, that until it identifies the actual savings in workload that may occur when the new law is implemented, it cannot evaluate the opportunities for performing audits of nonprofit hospitals or plan for the number or frequency of such audits.

We recommended that, after it identifies the staff resources that are no longer required for reviewing tax exemption applications, the tax board implement its plan to use those resources for performing audits of tax-exempt entities, including hospitals.

Tax Board's Action: Pending.

The tax board stated that it will focus on increased compliance audits, as resources are available.

Finding #4: The tax board has limited assurance that nonprofit hospitals remain eligible for state income tax exemptions.

The tax board does not use the tools available to it, such as annual filings and audits, to monitor the continuing eligibility of nonprofit hospitals for income tax exemption. According to management staff at the tax board, annual filings, which contain information such as financial data and changes in business activities, offer the tax board's Exempt Organizations Unit (unit) a useful tool for reviewing ongoing compliance with the requirements for maintaining tax-exempt status. However, the unit does not review the information in the annual filings. Management at the tax board stated that the large volume of initial applications for income tax exemptions and limited personnel prevent unit staff from reviewing the annual filings. In the absence of monitoring by the tax board, hospitals exempt from income taxes sometimes submit annual filings that do not contain all the information required by the form or its instructions or information required under the California Code of Regulations (regulations).

Regular auditing is another tool the tax board could use to monitor the tax-exempt status of nonprofit hospitals. However, the tax board does not regularly conduct audits of tax-exempt hospitals, even though, based on data provided by the tax board, the revenues of these hospitals represent 17 percent of the total revenue of all tax-exempt organizations. According to the tax board, an audit can originate when members of the public express concern that a tax-exempt organization may be functioning in a manner requiring revocation of its tax-exempt status. The tax board indicated, however, that it could not identify any complaints that might have prompted audits of tax-exempt hospitals, because it does not maintain a central record of the receipt or disposition of those complaints. Rather, complaints against tax-exempt organizations are stored in the tax board's files and cannot be easily retrieved.

The tax board stated that the revenue information from annual filings entered into its automated record-keeping system could be used to identify income-tax-exempt nonprofit hospitals to be considered for audit. However, because the tax board has not ensured that all tax-exempt nonprofit hospitals are distinctly identified in its electronic data system, it is unable to efficiently generate a list of the hospitals that might require audits. According to the tax board, creating such a list would necessitate manually reviewing the hard-copy files of the approximately 72,000 tax-exempt organizations operating in the State to determine which are tax-exempt hospitals.

Finally, the tax board told us that the IRS expects to perform an audit within three to five years after each organization receives a federal tax exemption, and it would notify the tax board of any revocations. However, the tax board does not currently coordinate with the IRS to identify audits of California tax-exempt hospitals in a manner that would allow the tax board to adequately rely on IRS audits for assurance of continuing eligibility.

We recommended that the tax board consider developing methodologies to monitor nonprofit hospitals' continuing eligibility for income tax exemption. These methodologies should include the following activities:

- Review the financial and other information from the annual filing submitted by hospitals exempt from income taxes.
- Ensure that the annual filing contains all the information the tax board's regulations specify as necessary for determining eligibility for an income tax exemption.
- Track complaints in a manner that enable the tax board to identify potential trends in noncompliance by income-tax-exempt hospitals and initiate audits of those hospitals.
- Adequately identify tax-exempt hospitals in its automated database, enabling it to use the information in the database to profile those hospitals and identify any potential noncompliance with the law.

The tax board should also gain an understanding of the frequency and depth of IRS audits of tax-exempt hospitals to identify the extent to which it can rely on IRS audits and factor that reliance into its monitoring efforts.

Tax Board's Action: Pending.

The tax board indicated that it plans to begin to develop an audit program to review the annual filings for hospitals to gain a better understanding of the compliance issues and materiality thresholds for ongoing reviews. It also stated that it has already implemented a new procedure to log all complaints into a computer database that documents the organization name, type, issue, and action taken. Additionally, the tax board indicated that as resources are available, it will begin updating the codes to separately identify tax-exempt hospitals from other types of charitable organizations. Finally, it stated that it is currently finalizing a memorandum of understanding (MOU) with the IRS that will allow the tax board to receive additional information on tax-exempt organizations. In addition to notification of final IRS actions authorized under the existing MOU, the new agreement will entitle FTB to receive information on proposed denials, revocations, and audit adjustments and names or organizations that have applied for federal exemption.

Department of Housing and Community Development

Awards of Housing Bond Funds Have Been Timely and Complied With the Law, but Monitoring of the Use of Funds Has Been Inconsistent

REPORT NUMBER 2007-037, SEPTEMBER 2007

Department of Housing and Community Development's response as of November 2007

In November 2002 and 2006, California voters passed the Housing and Emergency Shelter Trust Fund acts to provide bonds (housing bonds) for use in financing affordable housing for low- to moderate-income Californians. The Department of Housing and Community Development (department) and the California Housing Finance Agency (Finance Agency) manage the programs funded by the housing bonds.

The California Health and Safety Code, sections 53533 and 53545, requires the Bureau of State Audits to conduct periodic audits of housing bonds activities to ensure that housing bond proceeds are awarded in a manner that is timely and consistent with legal requirements and that awardees use the funds in compliance with the law.

Finding #1: Awards of housing bond funds were timely.

The department and Finance Agency have generally met and sometimes exceeded the goals specified in awards schedules they established in 2002 and 2003 for the 2002 housing bonds. For all complete fiscal years we audited, except fiscal year 2002–03, actual awards exceeded estimated awards.

Finding #2: The department and the Finance Agency generally complied with legal requirements when awarding housing bond funds.

The department and the Finance Agency generally allocated and awarded housing bond funds for the intended programs, to the correct types of sponsors, and for the proper activities. We noted that the Finance Agency's California Homebuyer's Downpayment Assistance Program (Downpayment Assistance Program) and the department's CalHome, Joe Serna Jr. Farmworker Housing (Farmworker Housing Program), and Multifamily Housing programs complied with legal requirements. However, poor file management in the department's Emergency Housing and Assistance Program (Emergency Housing Program) made it impossible for us to verify if the department always assessed applicants' submissions according to criteria for their capability as set forth in program notices. These criteria include minimum standards.

We recommended that the department implement record-keeping procedures for the Emergency Housing Program to ensure that applicants who receive awards have been properly evaluated.

Audit Highlights . . .

Our review revealed that for the Housing and Emergency Shelter Trust Fund Act of 2002:

- *Both the Department of Housing and Community Development (department) and California Housing Finance Agency (Finance Agency) generally awarded funds in a timely manner.*
- *Both the department and Finance Agency generally complied with legal requirements for making awards; however, the department could not provide its rating and ranking tools in some cases for its Emergency Housing and Assistance Program (Emergency Housing Program).*
- *Both the department and Finance Agency generally used appropriate monitoring procedures during the expenditure phase, but the department sometimes overrode controls concerning advance payments for the CalHome Program.*
- *The department does not exert adequate monitoring over the completion phase for two of its programs—Emergency Housing and CalHome.*

Department's Action: Pending.

The department reports that it drafted standardized record filing and maintenance procedures for the Emergency Housing Program and expects to finalize the procedures by the end of October 2007. In addition, by February 2008 the department anticipates the file review and organization effort will be completed.

Finding #3: The department and the Finance Agency generally undertake appropriate monitoring procedures during the expenditure phase.

For the expenditure phase (the period from award commitment to final state payment to an awardee), the department and the Finance Agency have processes in place to ensure that awardees exhibit reasonable progress in meeting their goals and are only reimbursed for allowed costs. However, we found that for three of the 18 CalHome awards tested, 17 percent of our sample, sponsors received advances exceeding the 25 percent limit established in their standard agreements. For example, the department approved a 100 percent advance on the last day funds were available for disbursement to one awardee based only on a list of potential home buyers. In these cases, the department overrode what appears to be a reasonable policy to ensure the delivery of services close to the time of payment and to maximize the State's interest earnings. Had the department retained the funds advanced over the 25 percent threshold for the three awards, we estimate it could have earned $42,000 in interest through July 2007 based on the effective yield of the State Treasurer's Office pooled money account.

We recommended that the department consider eliminating its process of overriding restrictions on advances for the CalHome Program.

Department's Action: Pending.

The department stated that it is establishing clear procedures to guide staff in evaluating circumstances in which an advance above the 25 percent limitation may be appropriate and documenting the justification received from the awardees. The department indicated that these procedures will ensure that exceptions are allowed only after there is clear documentation that the awardee has a proven history of making loans on a timely basis and that the amount requested is reasonable in consideration of the anticipated loan closing schedule.

Finding #4: For two programs, the department does not have adequate monitoring processes for the completion phase.

Of the five programs we reviewed, only Downpayment Assistance, Farmworker Housing, and Multifamily Housing had processes in place to adequately ensure compliance during the completion phase. This phase extends from the final state payment to fulfillment of all contract requirements. However, the CalHome and Emergency Housing programs administered by the department had weak or nonexistent monitoring during the completion phase. Consequently, the department cannot always be certain that sponsors are using bond funds to help intended beneficiaries, such as low- to moderate-income home buyers or homeless individuals.

We found that for 17 of the 18 CalHome Program awards we tested, the department had not verified any of the information provided whether through site visits or by reviewing original documentation, even though the sponsors had received all funds. For the remaining award, the sponsor had not yet received any funds. As a result, the department cannot be certain that sponsors complied with housing bond requirements related to occupants' income limits or their status as first-time home buyers.

Similarly, for the Emergency Housing Program, we found that the department had not performed site visits to verify sponsor activities for any of the awards we tested that were in the completion phase. Moreover, the program manager said that the program has not performed any site visits since 2005 and even then, it did not have formal policies and procedures governing the purpose and documentation requirements for site visits. Without monitoring processes for verifying compliance, the department cannot ensure that sponsors use funds in accordance with housing bond requirements or that the program benefits the intended populations.

We recommended that the department give high priority to finalizing and implementing monitoring procedures for the CalHome and Emergency Housing programs, which do not currently have such procedures in place. In addition, we recommended that the department review its other housing bond programs that were not specifically evaluated in this initial audit to ensure that monitoring procedures are in place and operating.

Department's Action: Partial corrective action taken.

The department stated that it completed monitoring of eight CalHome awards. The department anticipates it will finalize and implement its new risk assessment procedure and monitoring program design in January 2008. In regards to the Emergency Housing Program, the department says it has developed draft criteria for selection of projects to be monitored and anticipates finalizing monitoring procedures no later than January 2008.

The department indicates it completed its review of the bond programs not included in the audit to determine whether appropriate in-progress and post-completion monitoring processes are in place. The department stated that for all but two housing bond programs now operating, monitoring processes were appropriate. For the two identified programs, the department's Audit Division is revising its audit plan to assure that awardees are carrying out their responsibilities. For new housing bond programs, the department stated that development of the monitoring processes will be a second step of the program design procedures that are currently underway.

Judicial Council of California

Its Governing Committee on Education Has Recently Proposed Minimum Education Requirements for Judicial Officers

REPORT NUMBER 2005-131, AUGUST 2006

The Judicial Council of California's Administrative Office of the Courts' response as of August 2007

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:

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.***

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: Corrective action taken.

The Rules of Court adopted by the Judicial Council require judicial officers to maintain records that show participation in judicial education. Additionally, 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 in December 2006 the governing committee began, with the involvement of the advisory committees for trial court presiding judges and court executives, to develop a form for presiding judges to use to track judges' participation in judicial education. Subsequently, the governing committee submitted its recommendation of the form to the Executive and Planning Committee of the Judicial Council in March 2007, at which time the recommendation for the form was approved. AOC staff created both manual and automated versions of the forms in late July 2007, and requested presiding judges to use the forms to track judges' participation in judicial education for the three-year period beginning January 1, 2007.

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, it planned to begin conducting annual reviews of all program offerings to ensure the goals of the curriculum-based approach are met.

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

Five county probation departments' responses as of November and December 2007

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.

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.*
- *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.*

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.

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 and assess whether probation and the program requirement are an effective deterrent for future acts of domestic violence for individuals who commit acts of domestic violence while in programs or after completing a program.

Butte County Probation Department's Action: Corrective action taken.

After consideration of the report recommendations, the Butte department stated that it believes weekly pre-court and quarterly roundtable discussions among the judge, deputy district attorney, defense counsel, probation officers, and treatment program representatives help develop the consistency of consequences the audit report recommends. The Butte department indicated that its batterers are brought before the court for any failure to abide by the treatment program. Recommendations related to progress reports and regular court appearances were not directed to the department in Butte County because we did not discover any deficiencies related to these areas at this department during the audit.

Los Angeles County Probation Department's Action: Partial corrective action taken.

In its original response to the audit, the department in Los Angeles County, in consultation with the court in the county, indicated that it believes that the recommendation related to graduated consequences interferes with the discretion of individual judges and that regular court appearances would only be necessary for court-supervised probationers, not batterers on formal probation. We have not received any further communications from the county on this matter. Recommendations related to progress reports and court notifications of violations were not directed to the department in Los Angeles County because we did not discover any deficiencies related to these areas at this department during the audit.

Riverside County Probation Department's Action: Corrective action taken.

The Riverside department provided us with an outline of the graduated consequences the court in the county has established to guide its bench officers in their handling of treatment program attendance and enrollment violations for misdemeanor domestic violence cases in the county. Among other things, the outline indicates that on the fourth violation, probation will be terminated and the individual will serve extensive jail time.

The Riverside department explained that, because of an overburdened court system, the court is not able to have regular court appearances for all batterers and expects the probation department to attempt to resolve minor violations before returning the case to the court. Consequently, the department explained that it is in the process of implementing a policy in which probation officers could reinstate batterers into a program after a first-time attendance or enrollment violation but would provide written notification to the court of this action. The court could then choose to set the matter for further hearing if need be. The recommendation related to progress reports was not directed to the department in Riverside County because we did not discover any deficiencies related to this area at this department during the audit.

San Joaquin County Probation Department's Action: Corrective action taken.

The San Joaquin department stated that, although it was not able to obtain consensus from the court on a set of graduated consequences for batterers, it did develop a set of graduated consequences for its probation officers to follow in making recommendations to the court following violations of probation. These consequences include a recommendation that a batterer's probation be terminated, with all remaining jail time imposed, for the fourth violation of probation.

The San Joaquin department stated that it has directed probation officers to refer batterers back to programs only after a violation of probation has been filed with the court and the court has directed the batterer back to the probation department. Due to the limited resources of the court, the department indicated that regular court appearances are not feasible at this time. Additionally, the San Joaquin department stated that the courts have requested that required progress reports from the programs be sent to the department and the department has assumed the responsibility of notifying the court of any required action.

San Mateo County Probation Department's Action: None.

The original and subsequent responses from the San Mateo department did not indicate that it jointly considered the report's recommendations with the court and other interested county entities. Rather, the department responded that to its knowledge the court has not established a set of graduated consequences but that it is confident that all probationers are consistently held accountable for probation violations. The department then added that its current practices related to notifying the court of violations and referring batterers back to programs will continue as they are until they are changed. Recommendations related to progress reports and regular court appearances were not directed to the department in San Mateo County because we did not discover any deficiencies related to these areas at this department during the audit.

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: None.

In its original and subsequent responses, the department in Los Angeles County provided no specific information from the court on this recommendation.

Riverside County Probation Department's Action: Corrective action taken.

The department in Riverside County indicated that the vast majority of domestic violence defendants are ordered into a 52-week batterer intervention program and that the court has attempted to correct any sentencing variation through training and ongoing communication. Additionally, the department stated that the court established countywide guidelines for sentencing all domestic violence clients, including the 52-week program requirement.

San Joaquin County Probation Department's Action: Partial corrective action taken.

The department in San Joaquin explained that, although it has requested otherwise, the court continues to give the department discretion on the type of treatment program batterers attend. However, the department has provided written guidance to its probation officers that, when making program referrals, they must consider the arresting offense and the nature of the relationship between the offender and the victim, not just the charge to which the batterer was convicted.

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: Corrective action taken.

The Butte department indicated that, in addition to developing a program application checklist and conducting comprehensive recertification reviews on its two programs, it has begun conducting biannual administrative reviews and quarterly program session visits. Further, the department stated that, although it faces information gaps because some batterers are court-supervised, it attempts to gather relevant statistical information from the programs on enrollments, successes, and program failures. The department commented that it is working on closing the information gaps to provide more relevant measures.

Los Angeles County Probation Department's Action: Corrective action taken.

The Los Angeles department indicated that, although it does not anticipate adding new programs, it has developed a checklist to review a program application should the need arise. In its original response to the audit, the Los Angeles department indicated that it conducts program site visits at least annually, and usually semiannually. These visits are to include sitting in on an actual program session and a review of a random sample of administrative files. The department stated that it considered the feasibility of conducting a customer service evaluation for batterers who complete a program but determined that it did not have the resources to undertake this process. The department also indicated in its original response to the audit that it is developing the means to track recidivism data for batterers on formal probation.

Riverside County Probation Department's Action: Corrective action taken.

The Riverside department indicates that it uses the penal code and a manual developed by the California Institute of Human Resources at Sonoma State University to approve and renew the approval of programs. The department stated that all of its programs now receive at least one administrative review and at least one program session review, as required. Finally, the Riverside department responded that it has considered a number of avenues for collecting relevant program statistics and is currently pursuing statistics from the program on the number of referrals and completions, as well as a client survey upon completion of the program.

San Joaquin County Probation Department's Action: Corrective action taken.

The San Joaquin department has developed written procedures for approving and renewing provider applications. The department indicates that it continues to conduct administrative and program session reviews as required. Finally, the department indicates that it has developed a system that allows program providers to submit information, such as enrollments, attendance, terminations, completions, and quarterly progress reports directly to the department in electronic format. The department stated that, in addition to creating "to do" action items for providers and probation officers, it will also allow the department to track outcome measures by individual provider.

San Mateo County Probation Department's Action: Partial corrective action taken.

To the recommendation regarding written policies and procedures for approving and renewing program applications, the San Mateo department responded, "This is our current practice," without providing any additional information indicating what it has done to correct the deficiencies we found when we visited the department. In regards to on-site program reviews, the department responded that it was not in compliance at the time of the audit but has now installed an annual review process as required. In regards to developing program measures, the department stated there are customer service forms available to all probationers and other members of the public.

State Bar of California

With Strategic Planning Not Yet Completed, It Projects General Fund Deficits and Needs Continued Improvement in Program Administration

REPORT NUMBER 2007-030, APRIL 2007

State Bar of California's response as of October 2007, January 2008

The State Bar of California (State Bar), established by the California State Constitution, is a public corporation with a mission to preserve and protect the justice system. The law requires every person admitted and licensed to practice law in a court in California to be a member unless the individual serves as judge in a court of record. The State Bar's 23-member board of governors (board) establishes policy and guides such functions as licensing attorneys providing programs to promote the professional growth of members of the State Bar.

State law requires the Bureau of State Audits to audit the State Bar's operations from January 1, 2006, through December 31, 2006, but does not specify topics the audit should address. For this audit we reviewed the implementation of the State Bar's long-range strategic plan, its financial forecasts of expected revenues and expenditures, its administration of the Legal Services Trust Fund Program (legal services program), and its implementation of the recommendations from our 2005 audit. The 2005 audit assessed how the State Bar monitored its disciplinary case backlog, followed procedures for processing disciplinary cases, prioritized cost recovery efforts, and updated forecasts of revenues and expenditures.

Audit Highlights . . .

Our review revealed that the State Bar of California:

- ***Began a strategic planning process in 2003; however, development of many departmental plans and performance measures are incomplete.***
- ***Does not prepare annual budgets based on the results of strategic planning, but rather on projected costs for current levels of staff and resources.***
- ***Is pursuing an increase in annual membership fees from active members to offset a projected deficit of almost $12 million in its general fund by December 2010.***
- ***Continues to await approval of additional authority to collect money related to disciplinary cases, but does not expect the new authority to significantly increase collections in the short term.***
- ***Needs to improve administration of its Legal Services Trust Fund Program to ensure that it maximizes revenue from interest on trust accounts attorneys establish and appropriately completes required monitoring activities.***
- ***Reduced its backlog of open disciplinary cases to 256 cases, moving closer to its goal of 200 backlogged cases.***
- ***Needs to continue improving its processing of disciplinary cases by consistently using checklists and conducting random audits.***

Finding #1: The State Bar has not fully implemented its strategic-planning process.

In 2001 the State Bar's board began developing and implementing a strategic management cycle to guide the State Bar's activities. As part of that process, the board developed the State Bar's long-range strategic plan. As an outgrowth of the board's planning activities, the State Bar's staff engaged in a departmental strategic-planning process intended to enhance operations and build a culture of continuous improvement in the State Bar. Although the board adopted the strategic plan in 2004, the State Bar still has not completed its strategic-planning process. Specifically, the State Bar has not fully developed planning documents for each of its departments that are intended to implement the board's strategic goals and specify the indicators needed to measure departmental performance in meeting those goals. These departmental plans were to include annually updated action plans intended to identify the actions necessary to meet strategic goals and prioritize the allocation of resources.

The State Bar completed the preliminary departmental plans by December 2005. The executive director instructed each of the departments to include all ideas and comments from staff in its operational plans recognizing that the plans would require edit and revision. The State Bar expected to finalize the plans during 2006. However, according to the State Bar's executive director, several challenges, such as reorganization of several departments and the retirement of three key senior executives, have slowed the revision process. The State Bar currently expects to complete the revisions to the departmental plans by July 2007.

In addition, the State Bar has begun to evaluate its information technology systems and is concerned that they may not be capable of effectively capturing performance measurement data identified in the departmental plans. The State Bar estimates the cost to upgrade its information technology systems will total $3.4 million to $5.8 million per year from 2008 to 2013; however, it has not yet identified a source of funds to pay for these upgrades.

Further, because its strategic-planning efforts are still incomplete, the State Bar has not been able to determine whether it is accomplishing the board's strategic goals and does not currently tie its annual budget to its strategic plan and performance measurement efforts. Rather, the State Bar's budget process focuses primarily on estimating the cost of current staff and other resources using known and anticipated price increases.

To ensure that the strategic plan is fully implemented in an effective and timely manner, we recommended that the State Bar do the following:

- Complete revisions of the departmental plans that will serve to implement the board's strategic goals and ensure that each departmental plan contains meaningful performance indicators that will measure how successfully goals are being met.

- Limit performance measurement to indicators that can be accurately tracked on an ongoing basis and measure desired outcomes.

- Ensure that its departments, during their departmental plan revision process, identify the objectives and performance measures that can be attained, considering existing resource levels and information technology capabilities. In addition, on an ongoing basis the departments should revise their annual action plans to update this information given additional information technology upgrades.

- Take the steps necessary to ensure its information technology systems can capture the required performance measurement data to support the projects needed to accomplish strategic-planning objectives, or devise alternative means of capturing this data such as using an Excel spreadsheet.

State Bar's Action: Partial corrective action taken.

The State Bar made revisions to the 14 departmental plans, as of April 30, 2007. The State Bar indicated that, going forward, its departments will submit a report of accomplishments and performance measure adjustments and proposed action plans in January or February each year.

In addition, as part of the overall review of departmental plans the State Bar has evaluated the usefulness, validity, and source of data and collection strategies for the performance measures. The State Bar has reviewed all departmental plans to determine whether the measures can be captured with the State Bar's existing technology.

Moreover, the State Bar stated that their information technology department is working on a strategy that will ensure that the systems that run the various business functions of the State Bar are modernized, sustainable, and capable of capturing and reporting relevant performance data. This plan is part of an overall agencywide plan to refresh its information technology capabilities that the State Bar anticipates will be funded in part by a $10 technology assessment to the members.

Finding #2: The State Bar projects deficits in its general fund.

Because it estimates the fees it will collect from the increased volume of membership will not keep pace with its rising costs, the State Bar forecasts it will face a deficit of nearly $12 million in its general fund by December 31, 2010. The State Bar uses its general fund to account for membership fee payments and revenues it receives that are not related to other fund activities and to account for the expenses for maintaining, operating, and supporting its attorney disciplinary process. The State Bar established its Public Protection Reserve Fund (reserve fund) in 2001 to set aside a portion of its general fund as a buffer in the event of a revenue shortfall, like that which occurred after 1997 when it was unable to obtain timely statutory authority to assess the base annual membership fee that funds its disciplinary function and other operations it pays for from its general fund. However, use of the reserve fund to mitigate the projected general fund deficit will not likely provide a satisfactory solution to the State Bar's projected imbalance between revenues and expenses in its general fund. It estimates that even if it uses the balance of the reserve fund to partially offset the projected deficit in its general fund, the combined balance in the two funds will still result in a deficit of about $6.3 million by December 31, 2010.

The State Bar's authority to assess a base annual membership fee is temporary, and historically the State Bar has needed the Legislature to reaffirm that authority every one to two years. Its current authority expires on January 1, 2008, unless extended before that date. The State Bar noted that to remedy the expected deficit, it is in ongoing discussions with key members of the Legislature to obtain statutory authority to increase the base annual membership fee for active members. The State Bar has determined it will need a $25 increase in the fee to eliminate its projected general fund deficit and provide funding for information technology upgrades. However, as previously discussed, it has not successfully completed its strategic planning process that will allow it to identify the resources it needs to meet its strategic goals and base its budgeting process on these identified resources. This fact could hamper its efforts to justify a fee increase.

In addition, the State Bar does not anticipate that pending approval by the California Supreme Court (supreme court) of procedures to help recover its costs to discipline members or recover payments to members' clients from the Client Security Fund will have an immediate significant impact. This new enhanced collection authority, when implemented, will allow the State Bar to use money judgment authority to attempt to collect costs from disciplined attorneys.

The State Bar is preparing to implement its enhanced collection authority when approved. According to the State Bar's chief financial officer, in anticipation of the supreme court's approval, the State Bar is attempting to organize available information regarding the unpaid amounts. For example, the State Bar is trying to find the most current addresses of debtors and merge that information with other pertinent data, such as case numbers, restitution orders, and amounts owed. In addition, the State Bar is formulating a policy to guide staff in determining which cases will be affected by the rule, and therefore should be pursued, and which cases will be most fruitful in terms of potential collections.

However, the State Bar does not expect that its current collection rate will increase appreciably in the near future. According to the State Bar's assistant chief general counsel, the disciplined attorneys whose debts make up most of the unpaid amount were disbarred or resigned with disciplinary charges pending. He stated these attorneys are generally financially distressed and unable to repay clients or the State Bar at the time of their disbarment or resignation. The chief assistant general counsel further stated that, according to the State Bar's outside counsel. In five to 10 years some of the disciplined attorneys will have sufficient earnings to seek loans and will want to reestablish their credit and disbarred attorneys may want to seek reinstatement to practice law. He noted that credit-reporting agencies would pick up abstracts of judgments that have been recorded in county recorders' offices, but that if the State Bar wanted to directly report the debts, it would need procedures to comply with the federal Fair Credit Reporting Act. The chief assistant general counsel stated that the State Bar is still considering the costs and benefits of reporting judgments to credit-reporting agencies.

Additionally, although the law currently assesses a yearly $10 per-member building fee, which the State Bar is accumulating in its building fund, it can only use those funds to acquire and improve facilities or other related capital expenditures. The State Bar anticipates accumulating the funds over the next seven years in anticipation of using the balance as part of a down payment for the purchase of a facility in Los Angeles.

To effectively allocate its resources and justify its membership fees we recommended that the State Bar align its budgets with the results of its strategic-planning process.

To ensure that it maximizes collection efforts and its ability to implement the Rules of Court as soon as the supreme court approves procedures allowing their use, we recommended that the State Bar do the following:

- Complete its database and input all available information on the Client Security Fund and disciplinary debtors.
- Implement its proposed policy for pursuing debtors.
- Complete its assessment of the costs and benefits of reporting judgments to credit-reporting agencies.

State Bar's Action: Partial corrective action taken.

To ensure the highest level of integrity in its automated system, the State Bar has contracted with an independent auditor to review current procedures and processes to ensure that judgments filed are accurate and the data has integrity as information moves through the system.

The supreme court approved the Rule of Court in April 2007. In July 2007 the board adopted a pursuit policy for court ordered disciplinary costs and Client Security Fund obligations, which was immediately implemented. The State Bar reported that, as of January 2008, it has been awarded 80 judgments.

The State Bar interviewed three collection agencies currently under contract with the Administrative Office of the Courts and submitted to the vendors a request for additional information and pricing to assure they can evaluate the costs and benefits of using some or all of the collection agencies' services. The State Bar has tentatively selected one of the vendors.

The State Bar's 2008 adopted budget has been redesigned to link its budget with its strategic planning process. The proposed budget is aligned with the State Bar's organizational and functional structures as defined by its strategic plan and presents basic workload and performance information in major program areas.

Finding #3: The State Bar needs to improve its legal services program and attorney discipline system.

For grant year 2006–07 the State Bar awarded $26.7 million in grant funds from the legal services program to provide civil legal assistance to indigent Californians. The funds for the program come primarily from interest on trust accounts attorneys establish for certain client funds, state budget appropriations, and an allocation of certain court filing fees. The State Bar does not ensure that all attorneys comply with the law requiring them to remit the interest on these trust accounts to the State Bar to support the legal services program. The State Bar reported that in 2006 it received about $15.8 million from attorneys' trust accounts. However, because about 25 percent of the practicing attorneys in California do not remit interest earned on clients' trust accounts that qualify for the legal services program or report that they do not maintain trust accounts, the State Bar does not know whether it receives all the funds it should to support the legal services program.

The State Bar asks attorneys to report when they open or close trust accounts or no longer handle such client funds; however, it does not investigate nonreporting attorneys to determine whether they should establish trust accounts and remit the interest to the State Bar. According to the State Bar's deputy executive director, the State Bar has no authority to mandate reporting and would need an amendment to the statutes or to the Rules of Court to gain the authority to mandate reporting from its members.

Additionally, the State Bar is responsible for on-site monitoring of grantees to determine whether they complied with the program's requirements. However, it does not always adequately perform or document monitoring reviews of the legal services program grantees. Despite the State Bar's grantee-monitoring visits scheduled for the three-year period from January 1, 2004, through December 31, 2006, 12 grantees did not receive program-monitoring visits, and 51 did not receive fiscal-monitoring visits. Further, the State Bar does not always retain documentation needed to demonstrate that staff have completed all the steps in the monitoring process.

A 2005 Bureau of State Audits' report assessed the efforts of the State Bar to address the backlog of disciplinary cases it began accumulating after temporarily losing its statutory authority in 1997 to assess a base annual membership fee. In 2005 the State Bar had 315 backlogged disciplinary cases. As of December 2006 the State Bar had reduced the backlog to 256 with the oldest cases dating back to 2003. This progress moved the State Bar closer to its goal of having no more than 200 backlogged cases.

Our 2005 audit also addressed the State Bar's inability to process disciplinary cases efficiently. In response, the State Bar created checklists to ensure that staff follow significant processing steps and developed random audit procedures to improve its oversight of the processing of disciplinary cases. However, the State Bar has not fully implemented either of these policies. Three of the 30 files we reviewed did not contain properly completed checklists, and supervising trial counsels who oversee the disciplinary case investigators do not always perform the random audits required by the State Bar's policy.

To ensure that it receives all the trust account interest income available for its legal services program, we recommended that the State Bar consider conducting activities, such as interviewing or surveying a sample of members who do not report whether they have established trust accounts. This would allow the State Bar to determine whether some members are holding clients' funds without establishing trust accounts and remitting the interest to the State Bar. If the State Bar finds that the nonreporting members do, in fact, hold client funds that are nominal in amount or are held for a short period of time, it should seek the authority to enforce compliance reporting.

To properly monitor recipients of grants under its legal services program, the State Bar should ensure that it performs and documents all required monitoring reviews; in addition, it should develop a plan to perform the fiscal on-site monitoring visits that were not performed while staying current with its ongoing monitoring requirements.

The State Bar should continue its efforts to reduce its backlog of disciplinary cases to reach its goal of having no more than 200 cases.

The State Bar should ensure that staff use checklists of significant tasks when processing case files and fully implement its 2005 policy directive for random audits of case files by supervising trial counsel.

State Bar's Action: Partial corrective action taken.

The State Bar transmitted to the supreme court for approval a proposal that would require each attorney to complete and maintain an online registration. If adopted by the supreme court, proposed Rule 9.8 specifically requires lawyers to report whether the attorney or the attorney's law firm has established and maintained one or more trust fund accounts required under Business and Professions Code, Section 6211.

The State Bar has decided to focus upon addressing the bigger solution through adoption of online reporting in lieu of undertaking the interim step of manually polling members to determine whether non-reporting members have trust fund accounts.

The State Bar stated that it is coordinating with the Administrative Office of the Courts to survey other grant-making organizations to assist in establishing best practices for monitoring processes and tools. The State Bar's legal services program staff brought monitoring visits current as of December 31, 2007.

Moreover, the State Bar's Office of the Chief Trial Counsel modified its department plan in May 2007 to, among other things, establish a revised goal of having no more than 250 open backlog cases at the end of each year, rather than the previous goal of 200 open backlog cases. Given staffing constraints, the State Bar feels that it may be difficult to achieve the revised backlog goal of 250 by the end of 2007.

Lastly, the State Bar's Chief Trial Counsel issued a memorandum to all affected staff reminding them to use the checklists and directs appropriate supervisory personnel to perform random audits on a monthly basis with respect to the open investigation files of investigators assigned to original disciplinary investigations. The memorandum also directs supervisory personnel to adequately document the random audits and to confirm that any necessary corrective action has been taken.

DNA Identification Fund

Improvements Are Needed in Reporting Fund Revenues and Assessing and Distributing DNA Penalties, but Counties and Courts We Reviewed Have Properly Collected Penalties and Transferred Revenues to the State

REPORT NUMBER 2007-109, NOVEMBER 2007

The Department of Justice's, State Controller's Office's, and Administrative Office of the Courts' responses as of November 2007

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits to review the implementation of the DNA act—specifically, the collection and management of money in county and state DNA funds. The audit committee noted that since the DNA act became effective, revenues associated with it were significantly lower than expected. Additionally, the Legislative Analyst's Office suggested that the revenue shortfall might be the result of counties not collecting the DNA penalty assessments or receiving only partial payments. Further, information posted on the Department of Justice (Justice) Web site showed that many counties, including five of the 10 largest, did not report collecting any DNA fund money for 2005. Consequently, the audit committee was concerned that the State may not be receiving its fair share of DNA fund money and that counties may not be using the funds as intended.

Audit Highlights . . .

Our review of the implementation of Proposition 69, the DNA Fingerprint, Unsolved Crime, and Innocence Protection Act (DNA act) revealed that:

- ***State law does not require counties to report collections related to the additional DNA penalty imposed by the July 2006 amendment to the DNA act; therefore, interested parties would not be able to obtain a complete picture of all the DNA penalty money collected and transferred to the State.***
- ***Information available on the Department of Justice's Web site as of June 2007 showed that 22 counties had not transferred any DNA money to the State in 2005 and 24 did not do so in 2006; however, based on the State Controller's Office's records, these counties actually transferred to the State $1.6 million in 2005 and $3.8 million in 2006.***
- ***Although there were no significant errors in assessing and distributing DNA penalties at the three counties we reviewed, some weaknesses in the courts' automated case management systems and internal controls resulted in minor errors in the assessment and distribution of DNA penalties.***

Finding #1: Reporting of data on county DNA identification funds needs to improve

The DNA act requires the courts to levy a penalty of $1 for every $10, or fraction thereof, on all fines, penalties, or forfeitures imposed and collected by the courts for all criminal offenses, including violations of the vehicle code but excluding parking violations (initial DNA penalty). The DNA act also requires each county's board of supervisors to submit an Annual County DNA Identification Fund Report (annual report) to the Department of Justice (Justice) and the Legislature detailing collection and expenditure information related to the initial DNA penalty. Further, the DNA act requires Justice to post data from the annual reports on its Web site. In July 2006 the DNA act was amended to levy an additional DNA penalty on all criminal and vehicle violations except parking violations (additional DNA penalty).

However, state law does not require counties to report collections related to the additional DNA penalty. Consequently, the information the counties report to Justice and the Legislature is incomplete and, as a result, the State cannot be fully assured that the counties are assessing and collecting all required DNA penalties. Based on our review of records maintained by the State Controller's Office (state controller), counties transferred to the State about $2.3 million in additional DNA penalties from July 2006, the month the additional penalty became effective, through December 2006, an amount that is not reflected on the Justice Web site. Further, the state controller's records also show that 11 counties did not report transferring any money from the additional DNA penalty to the State for 2006. We contacted each of these counties and were informed by representatives of nine of the 11 counties that they combined money they collected from the additional DNA penalty with their collections of the initial DNA penalty rather than identify their collections separately on the documentation sent to the state controller. Moreover, three of the nine counties indicated that they failed to transfer 100 percent of their collections to the State, as required by law. Rather, they only transferred 70 percent, the amount applicable to the initial DNA penalty. Additionally, an official from one county stated that, although the court was assessing and collecting the additional DNA penalty, due to a coding error, the county did not transfer its additional DNA penalty collections to the State until March 2007. Finally, an official from the court in the remaining county acknowledged that it did not begin assessing the additional penalty until September 2007.

Additionally, many counties failed to submit annual reports in 2005 and 2006. In particular, as of June 2007, 22 counties had not submitted the required annual reports to Justice for 2005 and 24 counties had not submitted the reports for 2006. Rather than report that the counties had failed to submit annual reports, the Justice Web site indicated that they had not transferred any DNA fund money to the State. However, based on records from the state controller, all but two counties had transferred certain DNA fund money to the State in 2005, and only one county failed to make the required transfers in 2006. The counties that did not submit annual reports on their 2005 collections actually transferred almost $1.6 million to the State, and the counties that did not submit reports on their 2006 collections transferred almost $3.8 million. Because the Justice Web site shows those counties as not transferring any money to the State, anyone attempting to use the data might erroneously conclude that many counties were not assessing any DNA penalties and that the State was not receiving money it was owed.

We recommended that the Legislature consider revising state law to require counties to include in their annual reports information on the additional DNA penalty established by Chapter 69, Statutes of 2006.

We also recommended that the Administrative Office of the Courts (AOC) contact the courts in the counties that did not report transferring to the State any money or only part of the money for the additional DNA penalty to determine whether they are appropriately assessing the penalty. Additionally we recommended that the state controller contact the auditor-controllers in the counties that did not report transferring to the State any money or only part of the money for the additional DNA penalty to ensure that counties and courts correctly assess, collect, and transfer the money to the State.

Finally, because state law requires Justice to make county-reported data available on its Web site, we recommended that Justice take several steps to ensure that data on county DNA fund activities are accurate. We recommended that Justice annually notify counties that they are statutorily required to submit reports on or before April 1 to the Legislature and to contact each county that does not submit an annual report by the deadline. Additionally, we recommended that Justice establish policies and procedures for posting county data on its Web site and clearly indicate on its Web site any county that failed to submit an annual report.

Legislative Action: Unknown

AOC's Action: Pending.

The AOC stated that it would take appropriate action if needed.

State Controller's Action: Pending.

The state controller agrees there needs to be greater communication on the subject of DNA revenue remittances and will inform all county auditor-controllers of the specific requirements of the DNA penalties. Additionally, the state controller's staff will ensure this subject is addressed at the next meeting between the state controller and the county auditor-controllers.

Justice's Action: Partial corrective action taken.

Justice stated that it would begin sending out form letters every February to all counties reminding them that the report for the previous year is due April 1. Additionally, Justice stated that a formal letter from the attorney general would be sent in May to those counties that have not submitted an annual report by the April 1 deadline.

Justice indicated that it is also preparing internal policies and procedures specific to posting county DNA fund data on it Web site. These policies and procedures will dictate that Web-postings will reflect future collections as "not reported" should a county fail to submit an annual report by April 1.

Finding #2: Courts need to improve their methods of ensuring the accuracy of DNA penalty assessments and distributions.

Although we did not discover any significant errors in the transactions we reviewed for the county superior courts of Los Angeles, Orange, and Sacramento, we identified weaknesses in data entry and processing internal controls that could affect many of the DNA penalties processed by all three superior courts. The monetary impact of the errors ranged from 1 cent to $54 per case. While not individually significant, the potential volume of the errors could prove to be material in amount.

For example, the DNA penalty distributions calculated by the case management system used by the Orange County Superior Court (Orange court) resulted in rounding errors affecting 22 of the 40 cases we reviewed. According to an official of the AOC, the case management system the Orange court uses is a precursor to the case management system that the AOC plans to eventually implement statewide. Additionally, based on a report issued by the Judicial Council of California (Judicial Council), California Superior Court criminal case dispositions totaled more than 6.4 million statewide for fiscal year 2005–06. Not every case disposition—the final outcome of a case, such as a case dismissal or criminal sentencing—results in penalty assessments. Nonetheless, the magnitude of the errors will be greatly increased unless the AOC ensures that the cause of the rounding errors in the precursor system is identified and corrected before it implements the new statewide system. Moreover, when an individual was allowed to make installment payments, the Orange court's case management system did not always distribute the payments according to the priority order established by law.

We also identified a data entry error related to a specific type of motor vehicle code offense occurring at one location of the Los Angeles County Superior Court (Los Angeles court). The resulting error appears to have been committed by one court employee and was recurring over at least a 12-month period between 2005 and 2006. Additionally, for three other cases we reviewed involving another Los Angeles court location, the court did not properly assess the DNA penalty for a particular type of misdemeanor offense. Finally, we found that the Sacramento County Superior Court (Sacramento court) erroneously transferred $292,000 to the State for payments received for various vehicle code violations. Because the relevant violations had resulted in the court allowing the offenders to attend traffic school, by law the county should have retained the payments received from the offenders.

We recommended that the AOC work with the Orange court to estimate the total dollar effect of the rounding errors in calculating the penalty assessment distribution to determine whether it will have a significant financial impact on the State. If the AOC determines that the impact will be significant, it should ensure that the Orange court makes the necessary modifications to the distributions calculated by its case management system. Further, as it proceeds with developing the statewide case management system, the AOC should ensure that the system correctly distributes payments to the appropriate funds in accordance with all applicable laws and regulations. The AOC should also ensure that the Orange court reevaluates and makes necessary corrections to the distribution priority order programmed into its case management system. Additionally, the AOC should ensure that the Los Angeles court corrects any manual coding errors and strengthens internal controls over data entry. Finally, the AOC should ensure that the Sacramento court continues its efforts to correct any overpayments made to the state DNA fund.

AOC's Responses:

Orange County's Action: Pending.

The AOC stated that the Superior Court of Orange County would increase the field definition for the number of decimal points used in rounding in order to accommodate appropriate precision for fund distribution. The estimated time of completion is March 31, 2008.

The AOC also stated that the Superior Court of Orange County will evaluate its current distribution priorities programmed into its case management system to ensure that they are in compliance with applicable state laws. As discrepancies are noted, the appropriate action will be taken to correct the distribution priority for current and future distributions. The estimated time of completion is January 31, 2008.

Los Angeles County's Action: Corrective action taken.

The AOC stated that the Superior Court of Los Angeles County agrees with our recommendation and has taken steps to ensure that manual coding cashier errors are identified and corrected.

Sacramento County's Action: Partial corrective action taken.

The AOC indicated that the Superior Court of Sacramento County concurs with our finding. The superior court stated that it has made the necessary corrections to processes and database systems to properly capture and distribute traffic school and red light penalties going forward.

Concerning the incorrect distributions of traffic school and red light collections, the Superior Court of Sacramento County has made corrections to an estimated 25 percent of the amounts. The process of reversing all the incorrect distributions will take a number of months. The superior court estimates that corrections to prior distributions will be completed by March 2008.

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

REPORT NUMBER 2005-119, FEBRUARY 2006

Department of Industrial Relations' and the California Department of Transportation's responses as of April 2007

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.

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.***

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 is impractical 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 find evidence that violations occurred. 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. Rather, the division indicates it is working with another division within the department 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 workplaces most likely to cause death or serious injury to workers.

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.

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

We investigated and substantiated an allegation that a Department of Industrial Relations (Industrial Relations) employee improperly used bereavement leave.

Investigative Highlight . . .

A Department of Industrial Relations employee improperly used bereavement leave for work missed while incarcerated.

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.

City of Los Angeles

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

REPORT NUMBER 2004-136, JANUARY 2006

City of Los Angeles, Office of the City Attorney's response as of March 2007 and the City of Los Angeles, Office of the City Administrative Officer's response as of August 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.

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.*

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. The Attorney's Office noted that as part of its budget development process for fiscal year 2007–08, it made such a request for resources to handle certain types of cases.

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 work to ensure that outside counsel costs are reported accurately, that the cost reports are prepared consistently and supported by source documentation. In addition, the Attorney's Office believes that reporting of outside counsel costs is significantly improved in accuracy and consistency with the added staff assigned to each proprietary department.

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 stated that its outside counsel committee prepares memos documenting its decisions to retain outside counsel. In addition, although its July 2006 response indicated that the Attorney's Office 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; in its one-year audit response, the Attorney's Office noted that it had not found a rating sheet capable of completely and accurately capturing all of the factors it considered when selecting outside counsel. The Attorney's Office stated that it remains open to the recommendation and will continue to explore its implementation.

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 when possible prior to retaining outside counsel and in almost all cases 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 is 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 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 August 2007

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.

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.*

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 requested to review our work papers in August 2006 to pursue corrective action. In addition, Forestry reported in March 2007 that it agreed that Employee A collected wages to which he was not entitled and had conducted its own investigation. Forestry also reported that it was assessing the adequacy of the documentation of its investigation and planned to recover overpayments and determine disciplinary action once the assessment was complete.

Forestry had not provided any other update as of August 2007.

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.

Forestry did not provide any other updates as of August 2007.

Department of Conservation

Investigations of Improper Activities by State Employees, July 2006 Through January 2007

INVESTIGATION I2006-0908 (REPORT I2007-1), MARCH 2007

Investigative Highlights . . .

An employee at the Department of Conservation:

- *Failed to disclose his stock ownership in at least 18 instances.*
- *Owned stock in two companies at the time he made business decisions affecting those companies.*
- *Misused state resources to assist his spouse's employer.*
- *Used his state e-mail to directly solicit donations from oil industry and regulated companies.*
- *Used the prestige of his state position to obtain discounts on his personal cell phone purchases.*
- *Sent more than 65 e-mails that were insubordinate or were of such a nature to cause a discredit to the division.*

In addition, the employee's manager failed to adequately monitor the employee's improper activities and failed to disclose his own stock ownership in at least seven instances.

Department of Conservation's response as of September 2007

We investigated and substantiated an allegation that an employee with the Department of Conservation (Conservation) engaged in various activities that were incompatible with his state employment, including using the prestige of his state position and improperly using state resources to perform work for the benefit of his spouse's employer, a charitable organization.

Finding #1: The employee misused state resources to engage in improper activities.

We found that the employee misused state resources to engage in numerous activities that were incompatible with his state employment, including misusing the prestige of his state position. We believe that the nature and extent of these improper activities caused a discredit to the State. Specifically, the employee engaged in the following improper activities:

- Failed to disclose stock ownership in oil industry companies and regulated companies.[1]
- Owned stock in a company at the time he issued permits to that company.
- Used state time and resources for fundraising.
- Solicited charitable contributions from oil industry companies and regulated companies.
- Used his state position to assist a charity.
- Requested and received personal discounts from a state vendor.
- Sent more than 65 e-mails that were insubordinate or of a nature to discredit the State.

The employee owns or has owned stock in a number of oil industry companies, including at least two regulated companies (Company A and Company J). However, he failed to disclose his ownership of stock in these companies, in violation of the Political Reform Act of 1974 (act).

As required by the act, Conservation requires the employee, who works in Conservation's Division of Oil, Gas & Geothermal Resources (division), and others in his job classification to annually complete

[1] The employee is required to disclose his stock ownership in companies regularly engaged in oil and gas exploration and related industries (oil industry companies), which includes regulated companies.

statements of economic interests because these employees have the authority to approve permits that allow companies to extract or produce oil or geothermal resources. Accordingly, the employee, his manager, and others in their job classifications are required to include on their statements of economic interests any investments in, interests in business positions in, and income from any business entity of the type that may be affected by their decisions. This includes, but is not limited to, stock ownership with a value of $2,000 or more in businesses that are regularly engaged in the extraction and/or production of oil, gas, or geothermal resources.

We obtained the employee's statements of economic interests for each year from 2000 to 2005. In each statement, the employee certified under penalty of perjury that he had no reportable business interests. However, information the employee stored on his state computer that he later confirmed as accurate indicated that the employee failed to disclose reportable investments every year during this time period. In particular, we found for those years at least 18 instances where the employee failed to disclose that his stock ownership in various companies exceeded $2,000 in value.

In addition, we believe the employee conducted himself in a questionable manner when he communicated with and approved permits for Company A, a company whose stock he owned at the time he approved its permit requests. Specifically, we believe that in doing so the employee may have violated the common law doctrine against conflicts of interest (doctrine). Similarly, we believe he also violated the doctrine when he made business decisions affecting Company B, the division's vendor for cellular phone services, while he owned stock in that company. The doctrine provides that a public officer is implicitly bound to exercise the powers conferred on him with disinterested skill, zeal, and diligence and primarily for the benefit of the public. Because he owned stock at the same time he approved permits for Company A and made purchases in his state capacity from Company B, we question whether the employee was able to make these business decisions with disinterested skill for the primary benefit of the State.

Further, we found that the employee misused his state e-mail—as well as other state resources—in a number of ways, and engaged in activities that were incompatible with his state employment while assisting his spouse in securing contributions on behalf of her employer, a charitable organization (Charity 1) in various capacities. These activities include soliciting donations from regulated companies even though he had been admonished for doing so in the past, and using his state position to facilitate Charity 1's potential purchase of a property on which he previously performed regulatory work.

The employee used his work e-mail account to send or receive more than 340 e-mails involving discussions of Charity 1 activities and events over the three-year period we reviewed. Nearly 80 of these e-mails involved soliciting donations for Charity 1 and in several instances he directly solicited donations from either oil industry or regulated companies. Many of the 340 e-mails indicate that the employee spent considerable state time and resources when serving as co-chairperson for an annual sponsorship event benefiting Charity 1 by assisting in planning and organizing the event and soliciting sponsorship donations from regulated and other oil industry companies for the event.

The employee also misused his state e-mail and improperly used his state position to facilitate Charity 1's attempt to purchase property from a property owner with whom he had previously interacted in his regulatory capacity as a state employee. The employee violated state law and Conservation's policy prohibiting its employees from using the prestige of their state positions for the gain of themselves or others when he contacted the property owner on behalf of Charity 1.

Moreover, the employee serves as the contact for the division's vendor for cell phone services, Company B. In this capacity, he has regular dealings with representatives of Company B. On two separate occasions the employee requested Company B to waive a $35 fee associated with his personal cell phone purchases. In his e-mail requests, the employee informed Company B that a large number of Conservation offices switched to Company B based on his recommendations. One could easily surmise from this request that Company B may have felt compelled to provide the discount in exchange for his continued efforts to recommend Company B to other Conservation offices. The employee's e-mail records show that Company B's representative agreed to waive the fee on both occasions.

Finally, our review of the employee's e-mail records also indicates that he regularly misused his state e-mail and engaged in a pattern of behavior that likely could be considered insubordinate or apt to cause a discredit to the State. Specifically, for the three-year period we reviewed, the employee sent or received more than 130 e-mails regarding personal financial matters. Most of these e-mails pertain to the potential value of specific stocks. At least 15 of them involved discussions of potential investments in either the oil industry or oil and gas industry companies. Further, we found that the employee sent more than 65 e-mails to coworkers, superiors, representatives of oil industry and regulated companies, and others that we believe were insubordinate or were of such a nature as to discredit the division.

Conservation's Action: Partial corrective action taken.

Conservation reported that it pursued adverse action against the employee and he resigned from state service. In addition, Conservation reported it has taken action to ensure that similar misconduct is not repeated. Included in its corrective action, Conservation stated that it has:

- Developed a web page that its employees can use to review ethics and conflict-of-interest requirements.
- Established an internal ethics advisory panel.
- Required all employees who complete statements of economic interests to complete the Attorney General's online ethics training seminar.
- Continued an internal investigation to ensure that the misconduct is not more widespread than identified in our report.

Finding #2: The manager failed to adequately monitor the employee and failed to disclose his own interests in oil industry companies.

Information the employee stored on his state computer indicates that the manager should have known that the employee was involved in charitable functions involving regulated companies and Charity 1. These documents show that the manager participated in the annual charity event in 2005 and 2006 for which the employee and a representative of a regulated company were co-chairpersons in 2006. Additionally, these documents indicate that nine oil industry companies were sponsors for the event. We determined that six of them had previously submitted applications to the manager's district office for approval. Thus, it appears that the manager was aware—or should have been aware—that the employee was again soliciting donations from the regulated companies.

Documents stored on the employee's state computer also indicate that Company L, a company engaged in an industry related to oil and gas exploration, paid the manager's $150 entry fee for the annual charity event in 2006. When we questioned the manager, he stated that he was not certain whether Company L paid his entry fee but said he did not pay the fee. The manager added that he also did not pay for his entry into the previous year's event and stated that it was not uncommon for oil industry companies to pay for his entry into similar events. When we reviewed information relating to the annual charity event held in 2005, we found indications that Company M, which has submitted applications to the manager's office for his approval, paid his entry fee for the event. By accepting gifts from companies his office regulates, the manager may have violated conflict-of-interest laws and policies that prohibit a state employee from receiving any gift from anyone seeking to do business of any kind with the employee or his department under circumstances from which it reasonably could be substantiated that the gift was intended to influence the employee or was intended as a reward for official actions performed by the employee.

Finally, in the course of our interview, the manager also acknowledged that he has owned stock in a regulated company as well as in other oil and gas industry companies. Specifically, the manager informed us that in 2004 he held stock exceeding $2,000 in value in three oil and gas industry companies, including Company A, and four oil and gas industry companies in 2005. When we asked why he did not report his ownership of stock in regulated companies on his annual statement of economic interests, the manager responded that he did not believe he owned enough to require him to report them.

Conservation's Action: Partial corrective action taken.

In addition to taking the corrective actions Conservation reported for finding #1, it also placed the manager on administrative leave while it further investigates his actions.

California Highway Patrol

Investigations of Improper Activities by State Employees, February 2007 Through June 2007

INVESTIGATION I2007-0715 (REPORT I2007-2), SEPTEMBER 2007

California Highway Patrol's response as of November 2007

We investigated and substantiated an allegation that the California Highway Patrol (CHP) wasted state funds when it purchased numerous vans that it left virtually unused for at least two years.

Investigative Highlights . . .

The California Highway Patrol:

» *Paid $881,565 for 51 vans it had not used for their intended purposes more than two years after it purchased them.*

» *Did not postpone its purchase of the vans until it needed them, resulting in $90,685 in lost interest earnings to the State.*

Finding: The CHP wasted state funds.

Using three purchase orders, the CHP bought 51 vans for its Motor Carrier program, surveillance, and mail delivery. However, as of June 30, 2007, the 30 vans purchased in October 2004 and the 21 vans purchased in August 2005—at a combined cost of $881,565—had not been used for the special purposes for which they had been purchased. In addition, the CHP has left all but five of the 51 vehicles virtually unused since it purchased them. Further, because the CHP did not postpone its purchases of the vans until it needed them, the State lost interest earnings of approximately $90,385.[1]

The CHP intended to use 48 vans for field inspections in its Motor Carrier program, two vans for surveillance purposes, and one van for mail delivery. Vehicles must be specially modified before they can be put to use for field inspections, surveillance, or mail delivery. However, the CHP does not expect to have any of the 48 vehicles that it purchased for field inspections modified and available for that use until October 2007—more than two years after they were purchased. The CHP completed the necessary modifications to the mail van in June 2007, and as of August 2007 it reported that the modifications to the two surveillance vans were only 50 percent complete because of the State's failure to approve a budget in a timely manner.

In addition, our review of vehicle mileage information shows that the CHP left 46 of the 51 vans almost entirely idle, parked on the CHP property in an outdoor location. Specifically, we determined that as of April 2007 the CHP had driven the 46 vans a total of only 401 miles—an average of nine miles for each van—since it had purchased them in 2004 and 2005. We found that 14 vans had not been driven at all, another 27 vans had been driven from one to 20 miles, and five vans had been driven from 21 to 34 miles. Most of the mileage related to trips to facilities where various items such as roof vents, antennas, and flooring needed to modify these vehicles for their intended purpose were installed. The CHP used the remaining five vans for temporary assignments or to transport equipment. As of April 2007 the Highway Patrol had driven each of the five vans between 167 and 3,420 miles, or an average of 1,901 miles.

1 This amount is based on interest rates available to the State through its Pooled Money Investment Account Earning Yield Rate.

The CHP gave several reasons for not using the 51 vans for their intended purposes between the time it purchased them in 2004 and 2005 and the completion of our investigation in June 2007. The CHP told us that it planned to assign the vans to the field in fiscal year 2006–07. Further, it stated that modification of the vans had been delayed because of competing priorities, staff shortages, and the development of an equipment strategy that could meet all its users' needs. The CHP officials we interviewed told us that the vans were originally intended for modification and use within the CHP's normal replacement cycle time of approximately 18 months from purchase. However, the CHP stated that because of its workload, the labor-intensive installation of equipment in the two vehicles it purchased for surveillance was delayed beyond the normal cycle. In addition, the CHP officials stated that, although it completed modifications to the mail van, the CHP did not plan to use it until the mail van it was intended to replace either reaches the replacement mileage target of 150,000 miles or was no longer cost-effective to operate. Further, the CHP stated that modification of the 30 vans it received in October 2004—originally scheduled for April 2006—was canceled because of an unforeseen increase in demand for marked patrol cruisers. However, it appears the CHP had not yet developed an equipment strategy for the Motor Carrier program vans at the time it was modifying the marked patrol cruisers.

The CHP did not develop a workable strategy to make the 48 vans it purchased for the Motor Carrier program available for field use prior to making the purchases in 2004 and 2005. We believe the primary cause for delays was the CHP's attempt to develop a prototype vehicle design that could meet the needs of all of its employees who perform field inspections. The CHP developed two prototypes and it expected to complete the second prototype in September 2007, more than two years after it received its first shipment.

CHP's Action: Corrective action taken.

The CHP stated it had revised its fleet operations manual to address the manner in which its vehicles are equipped, painted, and marked. It also now requires the CHP commissioner's approval for any vehicle modifications or redesign.

In addition, the CHP stated that delays in equipping the vans were not due to the lack of a workable strategy but were instead the result of its decision to cease its normal process of equipping the vehicles under its existing configuration while awaiting the completion of the prototype. Further, the CHP stated that as of November 6, 2007, all 51 vans had been assigned to locations across the state.

Finally, the CHP asserted that, had it delayed the van purchases until the equipment design was resolved, it would have spent $235,233 more for 51 vans than it did for the vans mentioned in our report. Thus, the CHP believes that because it incurred no additional cost to store the vehicles on its property, its decision to purchase these vans more than two years before they were needed or used represents a savings of $235,233. We disagree with this assertion because it ignores the $90,385 in interest the State would have earned if the funds had remained in the State Treasury. Further, the CHP's analysis does not recognize the difference in product quality and resale value of the 2007 and 2008 model year vehicles when compared to the 2004 and 2005 model year vehicles it purchased.

California Exposition and State Fair

Investigations of Improper Activities by State Employees, July 2006 Through January 2007

INVESTIGATION I2006-0945 (REPORT I2007-1), MARCH 2007

California Exposition and State Fair's response as of October 2007

We investigated and substantiated an allegation that Official A, a high-ranking officer at the California Exposition and State Fair (Cal Expo), violated conflict-of-interest laws by participating in a state purchasing decision from which he received a personal financial benefit.

Investigative Highlight . . .

An official at the California Exposition and State Fair (Cal Expo) violated conflict-of-interest laws when he sold his personal vehicle to Cal Expo.

Finding: Official A violated state conflict-of-interest laws when he made or directed a governmental decision that authorized Cal Expo to purchase his personal vehicle.

Official A sold his personal vehicle to Cal Expo in July 2005. Because he was involved in the decision to make this purchase while acting in his official capacity and because he derived a personal financial benefit from this transaction, Official A violated the Political Reform Act of 1974 (act) and Section 1090 of the California Government Code (Section 1090).

Under the act, public officials at all levels of state government are prohibited from making, participating in making, or in any way attempting to use their official positions to influence a governmental decision in which they know or have reason to know they have a financial interest. Section 1090 prohibits a public official from participating in the formation of a contract or making a purchasing decision in which he or she has a financial interest.

Although Official A did not sign the initial purchase order authorizing the transaction, he met with Official B and Manager 1 before the purchase to discuss whether Cal Expo should acquire the vehicle. Official A, along with Official B and Manager 1, agreed Cal Expo should purchase the vehicle. Official B, who reports directly to Official A, subsequently approved a purchase order, and Manager 1, who reports directly to Official B, certified that he received the vehicle. Official A subsequently submitted an invoice to Cal Expo for the sale, and Cal Expo paid Official A $5,900 with a check containing Official A's preprinted signature.

More than a year after it purchased the vehicle, Cal Expo became aware that the transaction was potentially a violation of the law and subsequently reversed the transaction by returning the vehicle to Official A and requiring him to pay back the $5,900. However, Cal Expo's actions were not consistent with the remedies available under state law because Cal Expo was entitled to recover the $5,900 it paid for the vehicle and to retain the vehicle itself. By simply returning the vehicle to Official A, Cal Expo did not pursue the remedy that would have provided greater protection of the State's interest.

Cal Expo's Action: Corrective action taken.

In March 2007 Cal Expo reported that it believed invalidating the transaction and returning the vehicle were appropriate remedies. It also believed, because of Official A's record, that formal disciplinary action and criminal prosecution were not warranted. However, Cal Expo shared our concern that this serious ethical breach merited further action. In July 2007 Cal Expo reported that its Board of Directors, management, and supervisory staff had completed an ethics training course. It also reported that at the Board of Directors' meeting in September 2007, it approved a new accounts payable policy, requiring two officials to sign any checks made payable to Cal Expo employees other than for travel reimbursements and prohibiting Cal Expo officials from signing any checks written to themselves.

Appendix

Summary of Monetary Benefits Identified in Audit Reports Released From July 1, 2001, Through December 31, 2007

We estimate that auditees could have realized more than $1.16 billion of monetary benefits during the period July 1, 2001, through December 31, 2007, if they implemented our recommendations. The table 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 A

Monetary Benefits July 1, 2001, Through December 31, 2007

AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
July 1, 2007, through December 31, 2007		
I2007-2 (Allegation I2006-1099) (September 2007)	*Department of Mental Health: Investigations of Improper Activities by State Employees* Cost Avoidance—Misuse of state funds designated to purchase two law enforcement vehicles by using the vehicles for non-law enforcement purposes.	$19,000
2007-037 (September 2007)	*Department of Housing and Community Development: Awards of Housing Bond Funds Have Been Timely and Complied With the Law, but Monitoring of the Use of Funds Has Been Inconsistent* Increased Revenue—Excessive advances are provided without consideration for interest earnings the State could receive. Without corrective action, this loss could continue for the life of the program.	38,000
I2007-2 (Allegation I2007-0715) (September 2007)	*California Highway Patrol: Investigations of Improper Activities by State Employees* Cost Avoidance—Purchase cost of $881,565 for 51 vans it had not used for their intended purposes. $90,385 of lost interests because it bought the vans two years prior to when it needed them.	972,000
2007-109 (November 2007)	*DNA Identification—Improvements Are Needed in Reporting Fund Revenues and Assessing and Distributing DNA Penalties, but Counties and Courts We Reviewed Have Properly Collected Penalties and Transferred Revenues to the State* Increased Revenue—Counties did not always assess and collect all required DNA penalties.	31,800
Annualized carry forward from prior fiscal years:		**$197,344,000**
2001-107 (October 2001)	Port of Oakland	7,500,000
2001-120 (March 2002)	School Bus Safety II	44,300,000
2002-101 (July 2002)	California Department of Corrections	43,500,000
2002-009 (April 2003)	California Energy Markets	29,000,000
2002-118 (April 2003)	Department of Health Services	20,000,000
2003-125 (July 2004)	California Department of Corrections	20,700,000
2003-124 (August 2004)	Department of Health Services	4,600,000
I2004-2 (September 2004)	Department of Health Services	9,000
I2004-2 (September 2004)	Military Department	64,000
2004-105 (October 2004)	California Department of Corrections	290,000
I2005-1 (March 2005)	California Department of Corrections	119,000
2004-113 (July 2005)	Department of General Services	2,336,000
2004-125 (August 2005)	Department of Health Services	10,300,000
2004-134 (July 2005)	State Athletic Commission	33,000

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AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
I2005-2 (September 2005)	California Department of Corrections	$193,000
I2006-1 (March 2006)	Department of Fish and Game and other state entities	8,300,000
2006-035 (February 2007)	Department of Health Services	6,100,000
Totals for July 1, 2007, through December 31, 2007		**$198,404,800**
July 1, 2006, through June 30, 2007		
I2006-2 (Allegation I2006-0663) (September 2006)	*Department of Forestry and Fire Protection: Investigations of Improper Activities by State Employees* Cost Recovery—Between January 2004 and December 2005 an employee with the Department of Forestry and Fire Protection improperly claimed and received $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
2006-035 (February 2007)	*Department of Health Services: It Has Not Yet Fully Implemented Legislation Intended to Improve the Quality of Care in Skilled Nursing Facilities* Cost Savings/Avoidance—A contractor consultant authorized long-term care Medi-Cal duplicate payments. Health Services will recoup approximately $5.3 million from facilities that received duplicate payments and an additional $780,000 for duplicate or overlapping payments made to one or more different provider entities. Since authorization for the duplicate payments occurred because of a flawed procedure, the error may have caused other duplicate payments outside those we identified.	6,100,000
I2007-1 (Allegation I2006-0945) (March 2007)	*California Exposition and State Fair: Investigations of Improper Activities by State Employees* Cost Recovery—An official within the California Exposition and State Fair (Cal Expo) sold his personal vehicle to Cal Expo. Because he was involved in the decision to make this purchase while acting in his official capacity and because he derived a personal financial benefit, this official violated the Political Reform Act of 1974 (act) and Section 1090 of the California Government Code. Cal Expo has indicated that it has reversed the transaction regarding the vehicle, resulting in the reimbursement of $5,900 to Cal Expo and the return of the vehicle to the prior owner.	6,000
I2007-1 (Allegation I2006-0731) (March 2007)	*Department of Health Care Services: Investigations of Improper Activities by State Employees* Cost Recovery—An employee violated regulations covering travel expense reimbursements and payment of commuting expenses resulting in an overpayment of $7,453.	7,500
2006-501 (April 2007)	*Department of Corrections and Rehabilitation: It Needs to Improve Its Processes for Contracting and Paying Medical Service Providers as Well as for Complying With the Political Reform Act and Verifying the Credentials of Contract Medical Service Providers* Cost Recovery—Prisons failed to adequately monitor invoices for medical services resulting in overpayments of $5,700.	5,700
Annualized carry forward from prior fiscal years:		**$192,964,000**
2001-102 (July 2001)	Department of Insurance Conservation and Liquidation Office	300,000
2001-107 (October 2001)	Port of Oakland	7,500,000
2001-120 (March 2002)	School Bus Safety II	44,300,000
2001-128 (April 2002)	Enterprise Licensing Agreement	8,120,000
2002-101 (July 2002)	California Department of Corrections	29,000,000
2002-009 (April 2003)	California Energy Markets	29,000,000
2002-118 (April 2003)	Department of Health Services	20,000,000
2003-125 (July 2004)	California Department of Corrections	20,700,000
2003-124 (August 2004)	Department of Health Services	4,600,000
I2004-2 (September 2004)	Department of Health Services	9,000
I2004-2 (September 2004)	Military Department	64,000
2004-105 (October 2004)	California Department of Corrections	290,000

AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
2004-033 (May 2005)	Pharmaceuticals	$7,800,000*
I2005-1 (March 2005)	California Department of Corrections	119,000
2004-113 (July 2005)	Department of General Services	2,336,000†
2004-125 (August 2005)	Department of Health Services	10,300,000
2004-134 (July 2005)	State Athletic Commission	33,000
I2005-2 (September 2005)	California Department of Corrections and Rehabilitation	193,000
I2006-1 (March 2006)	Department of Fish and Game	8,300,000
Totals for July 1, 2005, through June 30, 2006		**$199,101,200**

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* Cost Savings/Avoidance—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. Increased Revenue—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. Cost Recovery—General Services reports it has recovered or established a monthly payment plan to recover $45,000 in previously unpaid parking fees.	$1,231,000
2004-134 (July 2005)	*State Athletic Commission: The Current Boxers' Pension Plan Benefits Only a Few and Is Poorly Administered* Increased Revenue—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* Increased Revenue—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* Cost Recovery—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
I2005-2 (Allegation I2004-0710) (September 2005)	*California Military Department: Investigations of Improper Activities by State Employees* Cost Recovery—A supervisor at the Military Department embezzled $132,523 in public funds; a court has subsequently ordered restitution of these funds.	133,000
I2005-2 (Allegations I2004-0649, I2004-0681, I2004-0789) (September 2005)	*California Department of Corrections: Investigations of Improper Activities by State Employees* Cost Recovery—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 $365,500, Corrections can save $192,500 annually by discontinuing this practice.	558,000

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AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
I2006-1 (Allegation I2005-0781) (March 2006)	*California Department of Corrections and Rehabilitation: Investigations of Improper Activities by State Employees* Cost Recovery—The Department of Corrections and Rehabilitation failed to exercise its management controls, resulting in gifts of public funds of $70,255 in leave not charged.	$70,000‡
I2006-1 (Allegations I2005-0810, I2005-0874, I2005-0929) (March 2006)	*Department of Forestry and Fire Protection: Investigations of Improper Activities by State Employees* Cost Recovery—Several employees of the Department of Forestry and Fire Protection received $61,466 in improper overtime payments.	61,000
I2006-1 (Allegations I2004-0983, I2005-1013) (March 2006)	*Victim Compensation and Government Claims Board and Department of Corrections and Rehabilitation: Investigations of Improper Activities by State Employees* Cost Recovery—The Department of Corrections and Rehabilitation (Corrections) improperly awarded payments to a physician at Corrections totaling $25,950.	26,000
I2006-1 (Allegation I2004-1057) (March 2006)	*Department of Fish and Game: Investigations of Improper Activities by State Employees* Increased Revenue—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.	8,300,000
2005-120 (April 2006)	*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* Cost Savings/Avoidance—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	45,000§
Annualized carry forward from prior fiscal years:		**$157,302,000**
2001-102	Department of Insurance Conservation and Liquidation Office	300,000
2001-107	Port of Oakland	7,500,000
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
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	7,800,000ll
I2005-1	California Department of Corrections	119,000
Totals for July 1, 2005, through June 30, 2006		**$178,285,000**

AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
July 1, 2004, through June 30, 2005		
2003-125 (July 2004)	*California Department of Corrections: More Expensive Hospital Services and Greater Use of Hospital Facilities Have Driven the Rapid Rise in Contract Payments for Inpatient and Outpatient Care* Cost Savings—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.	‡‡
2003-124 (August 2004)	*Department of Health Services: Some of Its Policies and Practices Result in Higher State Costs for the Medical Therapy Program* Cost Savings— 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.	$4,600,000
I2004-2 (Allegation I2002-0853) (September 2004)	*Department of Health Services: Investigations of Improper Activities by State Employees* Cost Savings—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.	9,000
I2004-2 (Allegation I2002-1069) (September 2004)	*California Military Department: Investigations of Improper Activities by State Employees* Cost Savings—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.	64,000
2004-105 (October 2004)	*California Department of Corrections: Although Addressing Deficiencies in Its Employee Disciplinary Practices, the Department Can Improve Its Efforts* Cost Savings—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.	290,000
I2005-1 (Allegation I2003-0834) (March 2005)	*California Department of Corrections: Investigations of Improper Activities by State Employees* Cost Recovery—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

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AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
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* Cost Recovery—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 as of April 2006.	$24,000**
2004-033 (May 2005)	*Pharmaceuticals: State Departments That Purchase Prescription Drugs Can Further Refine Their Cost Savings Strategies*	
	Cost Savings/Avoidance—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#
	Cost Recovery—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:		**$109,220,000**
2001-102 (July 2001)	Department of Insurance Conservation and Liquidation Office	300,000
2001-107 (October 2001)	Port of Oakland	7,500,000
2001-120 (March 2002)	School Bus Safety II	44,300,000
2001-128 (April 2002)	Enterprise Licensing Agreement	8,120,000
2002-009 (April 2003)	California Energy Markets	29,000,000
2002-118 (April 2003)	Department of Health Services	20,000,000
Totals for July 1, 2004, through June 30, 2005		**$122,133,000**

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* Increased Revenue—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* Cost Savings—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
2003-102 (December 2003)	*Water Quality Control Boards: Could Improve Their Administration of Water Quality Improvement Projects Funded by Enforcement Actions* Increased Revenue—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.	301,000
2003-117 (April 2004)	*California Department of Corrections: 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* Cost Savings/Avoidance—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.	96,000

AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
2003-138 (June 2004)	*Department of Insurance: It Needs to Make Improvements in Handling Annual Assessments and Managing Market Conduct Examinations* Increased Revenue—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.	$7,000,000
Annualized carry forward from prior fiscal years:		**$110,033,000**
2001-102 (July 2001)	Department of Insurance Conservation and Liquidation Office	300,000
2001-107 (October 2001)	Port of Oakland	7,500,000
2001-108 (November 2001)	California Department of Corrections	733,000††
2001-120 (March 2002)	School Bus Safety II	44,300,000
2001-128 (April 2002)	Enterprise Licensing Agreement	8,120,000
2002-107 (October 2002)	Office of Criminal Justice Planning	23,000
2002-009 (April 2003)	California Energy Markets	29,000,000
2002-118 (April 2003)	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

AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
2001-123 (July 2002)	*Deaf and Disabled Telecommunications Program: Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services* Cost Savings—Represents $200,000 in known unremitted collections from intrastate telecommunication charges and $68,000 in penalties and interest due for 2000 and 2001.	$268,000
2002-101 (July 2002)	*California Department of Corrections: A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management's Control* Cost Savings—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.	‡‡
2002-107 (October 2002)	*Office of Criminal Justice Planning: Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery* Cost Savings—Represents estimated annual savings from the elimination of duplicative work conducted by the State Controller's Office. This savings would recur indefinitely. However, in 2008, we decided to carry forward this cost savings through 2003–04 only.	23,000
2002-109 (December 2002)	*Department of Health Services: 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* Cost Savings—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.	911,000

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AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
2002-009 (April 2003)	*California Energy Markets: 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* Cost Savings—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.	$29,000,000
2002-118 (April 2003)	*Department of Health Services: 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* Cost Savings—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.	‡‡

Annualized carry forward from prior fiscal years:		**$61,103,000**
2001-102 (July 2001)	Department of Insurance Conservation and Liquidation Office	300,000
2001-107 (October 2001)	Port of Oakland	7,500,000
2001-108 (November 2001)	California Department of Corrections	883,000
2001-120 (March 2002)	School Bus Safety II	44,300,000
2001-128 (April 2002)	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)	*Department of Insurance Conservation and Liquidation Office: Stronger Oversight Is Needed to Properly Safeguard Insurance Companies' Assets* Cost Savings and Cost Recovery—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.	$1,728,000
2001-107 (October 2001)	*Port of Oakland: Despite Its Overall Financial Success, Recent Events May Hamper Expansion Plans That Would Likely Benefit the Port and the Public* Increased Revenue—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: Its Fiscal Practices and Internal Controls Are Inadequate to Ensure Fiscal Responsibility* Cost Savings and Cost Recovery—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

AUDIT NUMBER/DATE RELEASED	AUDIT TITLE/BASIS OF MONETARY BENEFIT	MONETARY BENEFIT
2001-120 (March 2002)	*School Bus Safety II: State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected* Cost Savings—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: The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars* Cost Savings—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: It Should Change Certain Practices to Better Protect the Public's Interests in Port-Managed Resources* Increased Revenue—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: 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* Cost Savings—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, 2007		**$1,160,156,000**

* Based on our follow-up work (Report 2007-501) we will discontinue claiming $7,800,000 as of fiscal year 2007–08 because the department of General Services (General Services) two new pharmaceutical contracts will expire November 2007. (See related footnote [||] below.)

† Based on our follow-up audit 2007-502, issued May 2007, we reduced General Services' expected $3 million of cost savings we reported in 2007 to $2.3 million of potential savings.

‡ This monetary benefit was previously listed at $66,000. Additional audit work resulted in additional cost recovery of more than $4,000 and based on updated information from the department, we eliminated the improper holiday accruals we reported in 2007.

§ We will discontinue claiming $45,000 as of this fiscal year. Recent changes to state law may impact the role previously performed by the Student Aid Commission (commission). Senate Bill 89 (SB 89), an emergency measure enacted as Chapter 182, Statutes of 2007, and signed by the governor on August 24, 2007, took effect immediately, and may affect the ownership of EDFUND, and impact the commission's oversight role. SB 89 prohibits the commission from authorizing EDFUND to perform any new or additional services unless they are deemed necessary or convenient by the Director of Finance (director) for the operation of the loan program or for maximizing the value of the state student loan guarantee program. Similarly, the director must approve any expenditure by EDFUND. Moreover, SB 89 provides that all actions, approvals, and directions of the commission affecting the state student loan guarantee program are effective only upon the approval of the director. Thus, the director now has significant authority over the commission and EDFUND.

|| This monetary benefit was previously listed at $5,100,000. However, according to General Services, its strategic sourcing contractor assisted it in negotiating two new pharmaceutical contracts for the period of November 2005 to November 2007 that General Services believed would result in increased savings to the State. Our follow-up report indicates that the State appears to have achieved savings of $7.8 million during the first 10 months of these two new contracts. See report number 2007-501 (June 2007).

This monetary benefit was not previously reported because General Services had not yet implemented the contracts resulting in this savings.

** This monetary benefit was previously listed as $2,700. The State Bar reported that it has since received an increased amount of cost recovery.

†† We will carry forward $733,000 through fiscal year 2003–04 only. Also, the $42 million of overtime cost savings is included with and reported under the monetary benefits of a later Corrections audit, audit number 2002-101, issued July 2002.

‡‡ 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.

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State and Local Entities With Recommendations From Audits Included in This Special Report

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