High Risk:

The California State Auditor's Updated Assessment of High-Risk Issues the State and Select State Agencies Face

June 2009 Report 2008-601

CALIFORNIA STATE AUDITOR

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June 25, 2009 2008-601

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

Dear Governor and Legislative Leaders:

As authorized by Chapter 251, Statutes of 2004, the Bureau of State Audits presents its report concerning its assessment of high-risk issues the State and select state agencies face. Systematically identifying and addressing high-risk issues can contribute to enhanced efficiency and effectiveness by focusing the State's resources on improving the delivery of services related to important programs or functions.

We have added three issues to our high-risk list. The first is the State's budget condition. The State has experienced ongoing deficits that greatly outweigh any surpluses, and much of the implemented solutions have only pushed the problem into the future. The second high-risk issue is the State's administration of the $85.4 billion the State expects to receive under the American Recovery and Reinvestment Act of 2009 (Recovery Act). We have identified concerns in the past related to certain state agencies' internal controls over their administration of federal programs; many of these are the same agencies that have received or will receive Recovery Act funds and must fulfill significant requirements or face penalties for noncompliance. The third high-risk issue is the production and delivery of electricity. The State has worked on the challenges of ensuring that sufficient capacity exists to generate needed electricity. However, the State is at risk of failing to meet targets to increase the use of renewable electricity sources, and new power plant construction may be somewhat offset by the need to replace environmentally harmful and aging plants in the near future.

We believe that the State continues to face at least five other significant high-risk issues: maintaining and improving infrastructure, management of human resources, other postemployment benefits of retiring state employees, emergency preparedness, and information technology governance. We further believe that three state agencies meet our criteria for high risk as they face challenges in their day-to-day and long-term operations: the California Department of Corrections and Rehabilitation, the Department of Health Care Services, and the California Department of Public Health.

We will continue to monitor the risks we have identified in this report and the actions the State takes to address them. When the State's actions result in significant progress toward resolving or mitigating these risks, we will remove the high-risk designation based on our professional judgment.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

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Providing the leadership, programs, and services the State needs is a complex business; the use of significant resources and the provision of critical services to the people of California are accompanied by risks. Systematically identifying and addressing high-risk issues can contribute to enhanced efficiency and effectiveness by focusing the State's resources on improving service delivery. Legislation effective in January 2005 authorizes the Bureau of State Audits (Bureau) to develop such a risk assessment process. We issued our initial assessment of high-risk issues the State and state agencies face in May 2007 (Report 2006-601).

Chapter 1 of this current report outlines the three issues we are adding to the high-risk list: the State's budget condition, the administration of federal funding received under the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the production and delivery of electricity. In Chapter 2 we provide an in-depth review of select issues of continuing high risk: maintaining and improving infrastructure, management of human resources, and other postemployment benefits (OPEB) of retiring state employees. In Chapter 3 we update our analysis of the remaining high-risk issues and departments facing risk and challenges: emergency preparedness, information technology governance, the California Department of Corrections and Rehabilitation (Corrections), the Department of Health Care Services (Health Care Services), and the California Department of Public Health (Public Health).

The first new issue the Bureau is adding to the high-risk list is the State's budget condition; the Bureau issued a report in February 2009 (Report 2008-603) that focused on this risk issue. In analyzing information on budget deficits and surpluses from the last 20 years, we found that all measures pointed to the same conclusion—the State has experienced ongoing deficits that greatly outweigh any surpluses. Moreover, nearly half of the amounts related to the budget solutions implemented to resolve the shortfalls have only pushed the problem into the future. A number of factors have made it difficult for decision makers to correct the long-standing budget imbalance. Examples of these factors include the two-thirds majority vote needed for lawmakers to raise state tax revenues, disproportionate increases in populations dependent on some of the State's most significant programs, voter-approved programs without revenue sources, and the State's dependence on personal income taxes for revenue.

Report Highlights . . .

Legislation effective in January 2005 authorizes our office to develop a risk assessment process. In May 2007 we issued our first assessment of high-risk issues facing the State.

We have added three issues to our high-risk list:

- *State's budget condition—ongoing deficits that greatly outweigh any surpluses.*
- *Administration of $85.4 billion of federal funds the State expects to receive under the American Recovery and Reinvestment Act of 2009.*
- *Production and delivery of electricity—possible unmet targets to increase the use of renewable electricity sources and need to replace certain power plants.*

The State continues to face the five significant high-risk issues previously reported:

- *Maintaining and improving infrastructure.*
- *Management of human resources.*
- *Other postemployment benefits of retiring state employees.*
- *Emergency preparedness.*
- *Information technology governance.*

The following three state agencies meet our criteria for high risk:

- *California Department of Corrections and Rehabilitation*
- *Department of Health Care Services*
- *California Department of Public Health*

The administration of federal funding related to the Recovery Act is our second new high-risk issue. California expects to receive $85.4 billion under the Recovery Act during fiscal years 2008–09 and 2009–10. The Recovery Act's intent is to stimulate the economy at the state and local level, as well as stabilize state and local governmental budgets. Significant requirements and penalties for noncompliance will be placed on entities that receive Recovery Act funds. Prior audit reports we and the Department of Finance have issued identify concerns related to certain state agencies' internal controls over their administration of federal programs. These control concerns, the large amounts of Recovery Act funds California expects to receive, and the requirements the Recovery Act imposes on recipients makes this a high-risk issue, as we reported in April 2009 (Report 2009-611).

Because California's electricity sector faces multiple challenges and problems related to energy production and consumption, the production and delivery of electricity is the third new issue the Bureau is adding to the high-risk list. This risk issue is described in a report the Bureau issued June 2009 (Report 2008-602). The reliable supply of electricity provides a critical foundation both for California's economy and its citizens' standard of living. In 2000 and 2001, California endured an energy crisis; the State has since worked to deal with the challenges of ensuring that sufficient capacity exists to generate the volume of electricity needed. For example, according to the California Independent System Operator, improvements to California's key transmission lines are complete. In addition, the California Energy Commission reports that it has approved 69 new power plants during the last decade. However, new power plant construction may be somewhat offset by the need to replace environmentally harmful and aging power plants in the near future and by the difficulties the State faces in doing so. Since the energy crisis, California has adopted targets to increase the use of renewable sources of electricity. However, the State is at risk of failing to meet these targets because various obstacles are preventing the construction of the infrastructure needed to generate and transmit electricity from such renewable sources as wind and solar. Finally, adding to the issues described above is a proposal currently before the Legislature to reorganize certain energy-related entities and create a new state Department of Energy, which presents additional uncertainties related to the State's ability to formulate strategic energy policies.

Maintaining and improving infrastructure remains on our high-risk list and is the first continuing issue we reviewed. The voters partially funded the State's infrastructure needs when they approved $42.7 billion in bond funds in November 2006. The governor has established a framework for infrastructure bond accountability, which the Bureau's February 2009 report (Report 2008-604) concludes that, if followed, the established controls should provide reasonable assurance that infrastructure bond proceeds are used as intended. Our review found that administering agencies had committed about $25 billion of the bond funds to specific infrastructure projects, and those agencies had spent about $7.3 billion. Infrastructure needs are less than 10 percent funded, and it is too early in the process to determine if established accountability tools are being used wisely.

The State's human resources management remains on the high-risk list and is the second continuing risk that we reviewed. The State is currently facing and will continue to face the retirement of a significant number of today's workers in both leadership and rank-and-file positions, as we reported in March 2009 (Report 2008-605). During the 20-year period between 1988 and 2008, the number of full-time permanent state employees has increased from 136,700 to 200,000, and the proportion of workers in older age groups has grown significantly. Since 2007 the Department of Personnel Administration (Personnel Administration) has focused much of its efforts on workforce planning—it considers succession planning a subset of workforce planning—and on modernizing and streamlining the State's human resource system to recruit, develop, and maintain a well-qualified, high-performing workforce. Personnel Administration hired a statewide workforce planning manager to educate agencies about the urgency of workforce planning and how to develop such plans; it is also streamlining the State's hiring process by using online testing. Unlike other states, California does not require departments to develop workforce and succession plans. Agencies we interviewed point to the State's lengthy hiring process and salaries lower than the private sector as barriers to replacing retiring employees.

The risks posed by paying and accounting for OPEB of retiring state employees remains on our high-risk list as we reported in April 2009 (Report 2008-607); OPEB is the third continuing issue we reviewed. Medical and dental benefits are the primary components of OPEB. The most recent actuarial study shows the State's total estimated OPEB liability is $48 billion. In addition, new accounting rules require the State to calculate the amount that it would need to pay each year to fully fund this liability—the annual required contribution—and record a liability to the extent that the contribution is not paid. Because it uses the pay-as-you-go method of funding its retirees' OPEB, the State addresses only the current year's costs and does not set aside funds to cover any future costs. For example, in fiscal year 2007–08, the State paid only $1.25 billion of the $3.59 billion annual required contribution for OPEB costs and consequently recorded an OPEB liability of $2.34 billion in its financial statements. The State's OPEB liability for fiscal year 2008–09 is projected to increase to $4.71 billion. A key risk is that the rapidly rising OPEB liability will affect the State's credit rating and its ability to borrow funds to finance its operations at the lowest available interest rates.

Emergency preparedness is an issue we originally identified as high risk, and it remains on our list. The State has taken several actions, such as enhancing preparedness in the medical care sector by purchasing medical equipment including three 200-bed mobile field hospitals, issuing guidance to assist the medical sector in planning for emergency responses, and helping to inform and prepare the public for emergencies. The State also formed the California Emergency Management Agency to help streamline emergency preparedness. However, its preparedness for emergencies is not complete. For example, a report issued in 2009 stated that California's public health workforce and laboratory capacity remain in need of significant attention and that a strong state laboratory is critical to the State's ability to identify and quickly respond to disease-based emergencies.

Information technology governance and oversight is another original high-risk issue needing further review. The State continues to need and develop large information systems, but it lacks a mature governance structure and strategic plan. The Legislature recently allowed to take effect the governor's proposal to reorganize many of the state information technology-related departments and functions under the Office of the State Chief Information Officer (Information Office). That reorganization is in its infancy. The Information Office's strategic planning process is also new. The office published two of three volumes of its strategic plan beginning in January 2009. As of mid-May 2009, the Information Office was drafting and reviewing the third volume, but it is too early to tell what results the plan will yield. Meanwhile, the State is moving forward with several large information technology projects ranging in cost from $178.6 million to $1.6 billion. These large projects present risk to the State, including developing a product that meets the State's needs and managing the cost of each project. At this time, information technology governance will remain on our high-risk list.

Corrections is one of the departments we originally identified as facing risks and challenges that have not subsided since our inaugural high-risk report. The department reports that as of March 31, 2009, its adult institutions are at more than 192 percent of the system's design capacity of one inmate per cell. Corrections' medical health care system is still under the receivership of the U.S. District Court for the Northern District of California, and the court recently rejected Corrections' motion to have the receivership removed. In fact, a three-judge court formed under federal law has opined that overcrowding is a primary cause of Corrections' unconstitutional system conditions, such as medical care, and has issued a tentative ruling directing Corrections to release inmates to reduce prison overcrowding. Additionally, Corrections still struggles to maintain consistent leadership: the governor appointed the fourth secretary for this department in the past three years, and for high-level headquarters positions and wardens, vacancy rates or positions filled with staff in an acting capacity remain at over 30 percent. Finally, Corrections stopped measuring progress against its existing strategic plan in fall 2008, when, under the direction of the new secretary, it began developing a new strategic plan. Corrections intends to complete this plan by summer 2009.

The final risks we analyze relate to the two departments that emerged after the splitting up of the Department of Health Services (Health Services): Health Care Services and Public Health. As we noted in our inaugural high-risk report, as new entities, Health Care Services and Public Health face challenges to ensure that they provide effective services in addition to meeting the Legislature's expectations for increased program accountability. Although each department has completed a strategic plan and began implementing these plans in 2008, more time is needed to prove these plans effective. In addition, for fiscal year 2007–08, the budgeted resources for the two departments were greater than Health Services' fiscal year 2006–07 budget; however, it is nearly impossible to determine which budget adjustments would have occurred under Health Services had the split not taken place.

We will continue to monitor the risks we have identified in this report and the efforts state agencies make to address them. To successfully mitigate these risks, we believe the State needs to take certain actions. For example, a responsible person, group, or entity needs to coordinate the activities necessary to address broad risk issues involving multiple agencies. Those responsible parties and the specific state agencies we have designated as high risk must demonstrate a commitment to address the identified risks and to commit sufficient resources to resolve them. As part of this effort, those designated with this responsibility should develop detailed and definitive action plans along with a process for independently monitoring and measuring the effectiveness of the steps taken. In addition to monitoring these actions, we plan to periodically evaluate the quality and effectiveness of the State's mitigating efforts by conducting audits. When state actions result in significant progress toward resolving or mitigating these risks, we will remove the high-risk designation based on our professional judgment.

Introduction

Background

Identifying and addressing high-risk issues in California's government can lead to the assessment and resolution of serious weaknesses in the State's use of significant resources and provision of critical services to its citizens. The process of systematically identifying and addressing high-risk issues can also contribute to enhanced efficiency and effectiveness, focusing the State's resources on improving the delivery of services related to important programs and functions. High-risk programs and functions include not only those particularly vulnerable to fraud, waste, abuse, and mismanagement but also those of particular interest to the citizens of the State and those that have potentially significant effects on public health, safety, and economic well-being.

Legislation effective in January 2005 authorizes the Bureau of State Audits (Bureau) to develop a risk assessment process for the State. In particular, Senate Bill 1437 of the 2003–04 Regular Session of the Legislature added Section 8546.5 to the Government Code. It authorizes the Bureau to establish a high-risk audit program, to issue reports with recommendations for improvement on issues it identifies as high risk, and to require state agencies responsible for these identified programs or functions to report periodically to the Bureau on the status of recommendations for improvement the Bureau makes.

The Bureau's Criteria for Identifying High-Risk Issues

We formulated considerations for developing a list of statewide issues and state agencies that we believe are at high risk for the potential of waste, fraud, abuse, and mismanagement or that have major challenges associated with their economy, efficiency, or effectiveness. In the Appendix we further describe the factors we considered: an agency's mission or functions and how it contributes to the State's overall performance, qualitative and quantitative factors, an agency's responsiveness to recommendations, and the quality of corrective measures. We also outline in the Appendix the factors we will consider in determining whether it is appropriate to remove a statewide issue or agency from our high-risk list.

Scope and Methodology

Government Code, Section 8546.5, authorizes the Bureau to audit any state agency that it identifies as high risk and to issue related audit reports at least once every two years. In May 2007 we issued a report that provided an initial list of high-risk issues the Bureau identified.

Subsequent to our May 2007 report, the Bureau continued to identify issues the State faced and evaluated them for inclusion on our high-risk list. We have issued separate reports for the three issues we added to the high-risk list: the State's budget condition, the administration of federal funding received under the American Recovery and Reinvestment Act of 2009, and the production and delivery of electricity. For select other issues that were included in our inaugural high-risk list, we performed in-depth reviews to determine whether the risks had been mitigated. We issued separate reports specific to the following issues: maintaining and improving infrastructure, management of human resources, and other postemployment benefits for retiring state employees. Each of these reports contains details of our scope and methodology for conducting the particular review.

For the updated analysis of remaining high-risk issues and departments facing risks and challenges—emergency preparedness, information technology governance, the California Department of Corrections and Rehabilitation, the Department of Health Care Services, and the California Department of Public Health—we interviewed knowledgeable staff at each entity with significant related responsibilities to assess their perspectives on the extent of risk the State faces and reviewed the efforts underway that they identified as mitigating the risks. We also reviewed reports and other documentation relevant to the issues.

Chapter 1

NEW ISSUES OF HIGH RISK

Chapter Summary

The Bureau of State Audits (Bureau) has identified three new high-risk issues: the State's budget condition, the State's system for administering the federal American Recovery and Reinvestment Act of 2009 (Recovery Act), and the production and delivery of electricity. As reflected in the text box, the Bureau has issued separate reports on each of these high-risk issues.

California's projected deficits have exceeded its budget surpluses by about $116 billion over the last 20 years. The State's decision makers have closed these budget deficits using various solutions, and many have simply pushed the deficits into the future. Significant factors contributing to budget deficits in California include increasing expenditures for services such as those provided to persons eligible for the California Medical Assistance Program (Medi-Cal) and costs associated with incarcerating inmates. Additionally, the State's revenue structure, which is dependent to a large degree on personal income taxes, is very sensitive to changes in the economy. Finally, legal constraints and humanitarian considerations provide significant challenges to reducing the State's expenditures. Because of these and other considerations, we added the State's budget to the list of high-risk issues in February 2009.

The following Bureau of State Audits' reports highlight new high-risk issues:

- *High Risk: The California State Auditor has Designated the State Budget as a High-Risk Area* (February 2009, Report 2008-603)
- *California's System for Administering Federal Recovery Act Funds* (April 2009, Report 2009-611)
- *High Risk: The California State Auditor has Designated Electricity Production and Delivery as a High-Risk Issue* (June 2009, 2008-602)

Source: Bureau of State Audits' Web site at www.bsa.ca.gov.

The second newly identified high-risk issue is the State's internal controls for administering funds it is receiving as part of the Recovery Act. California expects to receive $85.4 billion under the Recovery Act during fiscal years 2008–09 and 2009–10. The Recovery Act's intent is to stimulate the economy at the state and local level, as well as to stabilize state and local governmental budgets. Significant requirements and penalties for noncompliance will be placed on entities that receive Recovery Act funds. Prior audit reports we and the Department of Finance (Finance) have issued identify concerns related to certain state agencies' internal controls over their administration of federal programs. These control concerns, the large amounts of Recovery Act funds California expects to receive, and the requirements the Recovery Act imposes on recipients make this a high-risk issue.

The production and delivery of electricity is the third newly identified high-risk issue. In 2000 and 2001, California endured an energy crisis and the electricity industry is continuing to evolve to address problems the crisis highlighted while simultaneously working to introduce mechanisms to increase competition and to support the State's overall renewable energy targets. Since the energy crisis, the State has continued to deal with the challenges of ensuring that sufficient capacity exists to generate the volume of electricity needed, that California has the infrastructure necessary to transfer the electricity to the areas that most need it, and that the appropriate regulatory agencies work collaboratively in their efforts to ensure that an energy crisis does not reoccur.

The State's Budget Condition

Based on the recent fiscal crisis and a history of ongoing deficits, the Bureau announced that it had added the State's budget condition to its list of high-risk issues in a report issued in February 2009.[1] The record-breaking delays in passing the fiscal year 2008–09 budget, the need for subsequent special sessions, and the multibillion dollar budget gap lawmakers were attempting to close highlighted the potential for the State's budget process and condition to add significant roadblocks to the tasks of managing and improving state and local government.

In eight of the past 20 years, projected budget surpluses totaled about $30 billion, while projected shortfalls for the remaining 12 years totaled $146 billion.

In analyzing information on budget deficits and surpluses during the last 20 years, using various methods of determining the budget condition, we found that all measures pointed to the same conclusion—the State has experienced ongoing deficits that greatly outweigh any surpluses. For example, as indicated in Figure 1, when we examined the projected shortfalls and surpluses as of May[2] in each of the past 20 years, we found projected budget surpluses for eight of those years, totaling about $30 billion, and projected shortfalls for 12 years, totaling $146 billion. In addition, the largest surplus of $12.3 billion in fiscal year 2000–01 was far outpaced by the largest shortfall of $38.2 billion in fiscal year 2003–04.

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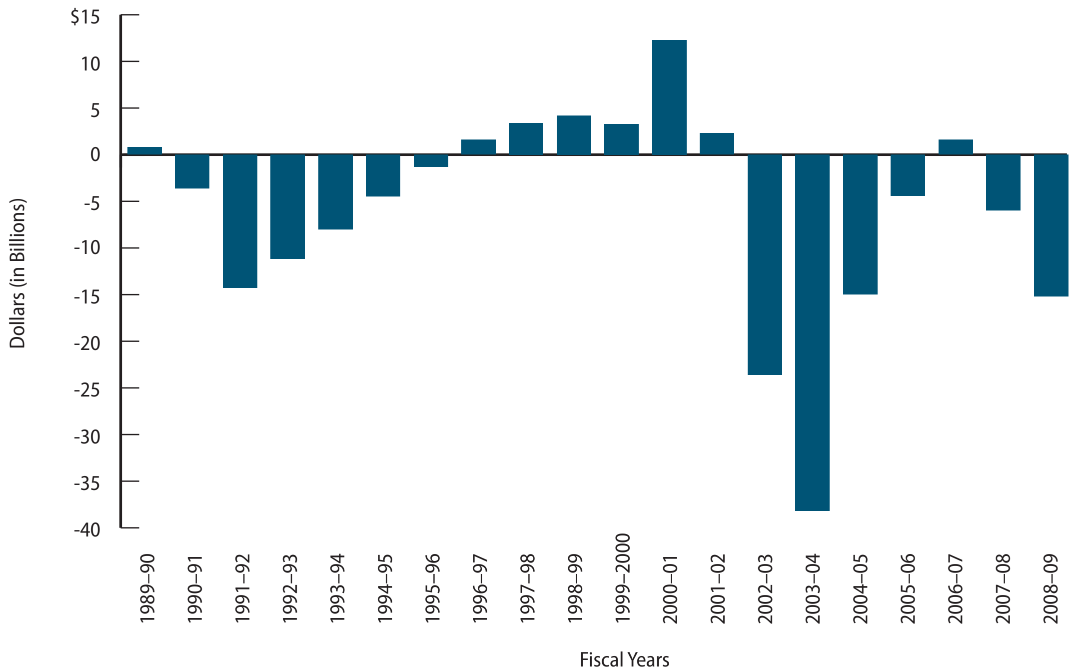
1 *High Risk: The California State Auditor Has Designated the State Budget as a High-Risk Area* (February 2009, Report 2008-603).

2 In May the governor and the Department of Finance publish a revision to the governor's budget issued in January—the revised budget is referred to as the 'May revision.' The May revision reflects updated revenue projections, expenditures, and other issues of interest or concern to the budgeting process.

Figure 1
Projected General Fund Budget Surpluses and Shortfalls as of the May Revision
Fiscal Years 1989–90 Through 2008–09



Sources: Department of Finance's governor's budget summaries and the May revisions; Legislative Analyst's Office's perspectives and issues, state spending plans, and overviews of the May revisions.

Although these results indicate that the State has faced a long-standing problem, nearly half of the amounts related to the budget solutions implemented to resolve the shortfalls have only pushed the problem into the future. Specifically, Table 1 on the following page shows that 27 percent of these amounts involved increasing the State's debt and another 22 percent were related to fund shifts and transfers, accelerated revenue payments that reduce future revenues, and expenditure deferrals.[3] These types of solutions contribute to larger budget shortfalls in subsequent years.

3 This 22 percent includes 11 percent from fund shifts and transfers, 5 percent from expenditure deferrals, and 6 percent from accelerated revenue payments. This last category represents only the portion of accelerated revenues that reduce future revenues, which is the reason the 6 percent for this category does not agree with the 9 percent shown in Table 1 on the following page.

Table 1
Types of Solutions Implemented to Reduce Budget Shortfalls
Fiscal Years 2002–03 Through 2008–09

	2002–03	2003–04	2004–05	2005–06	2007–08	2008–09	OVERALL
Total Amount of Budget Solutions (in Billions)*	$23.6	$39.4	$16.1	$5.9	$4.9	$24.0	$113.9
Percentage by Solution Type†							
Expenditure reductions	32%	21%	31%	71%	28%	36%	31%
Revenue increases	17	15	15	2	33	17	16
Increased debt	13	41	39	15		17	27
Fund shifts or transfers	12	10	15	12	26	4	11
Accelerated revenues	19	5			12	11	9
Expenditure deferrals	7	5				8	5
Accounting changes		2				8	2

Sources: Legislative Analyst's Office's California spending plans and various publications prepared by the Department of Finance pertaining to the enacted budgets.

Note: Fiscal year 2006–07 is not shown in the table because there was a projected budget surplus in that year.

* The solutions in this table do not precisely link with the May shortfalls presented in Figure 1 because of timing differences and the differences between the shortfalls and the solutions to resolve them.

† Some percentages do not add to 100 percent due to rounding.

Latest developments:

In May 2009 the State held a special election to vote on six measures concerning the State's budget: propositions 1A through 1F.

- 1A: Rainy day budget stabilization fund.
- 1B: Education funding. Payment plan.
- 1C: Lottery modernization act.
- 1D: Children's services funding.
- 1E: Mental health funding budget.
- 1F: Elected officials' salaries. Prevents pay increases during budget deficit years.

The State's voters passed proposition 1F, but rejected propositions 1A through 1E.

Source: Secretary of State's California Statewide Special Election Web site at http://vote.sos.ca.gov.

Other gap-closing solutions shown in Table 1 have more directly addressed shortfalls. Decision makers closed large parts of the gaps by reducing expenditures (31 percent) and increasing revenues (16 percent). However, of the $18 billion in increased revenues occurring over these six years, about $2.8 billion was realized by changing revenue assumptions, and these assumptions have not always proven to be accurate. Furthermore, decision makers face constitutional constraints that limit their ability to raise additional revenue to cover budget shortfalls. For example, as legislators and the governor worked to close a $15.2 billion gap for the 2008–09 budget year, they had the choices of decreasing spending, increasing revenues, issuing debt, or combining some or all of these options. However, because the California Constitution requires that all state tax revenue increases be approved by the Legislature with a two-thirds majority vote, this among other factors can make it difficult for decision makers to close budget shortfalls by increasing tax revenues.

Also, in the last two decades, certain segments of the population, to which the State has historically devoted more resources, increased at rates greater than that of the general population. As shown in Table 2, although the State's general population has increased by 28 percent, the number of inmates in correctional facilities has increased by 82 percent, the number of persons eligible for Medi-Cal has grown by 90 percent, and there are 32 percent more school-age children. This disproportionate growth has caused increases in the State's General Fund expenditures to outpace the combined rate of inflation and general population growth. For example, the population of persons eligible for Medi-Cal roughly doubled, from 3.5 million in fiscal year 1989–90 to 6.7 million in fiscal year 2007–08. Over the same time period, Medi-Cal costs have more than quadrupled, the program's General Fund budget has increased from $3.5 billion to over $14 billion.

Table 2
The Growth Rate of California's General Population Compared to the Growth Rates of Specific Groups
Fiscal Years 1989–90 Through 2007–08

FISCAL YEAR	GENERAL POPULATION	INMATES	PERSONS ELIGIBLE FOR MEDI-CAL	K-12 STUDENTS	HIGHER EDUCATION STUDENTS
1989–90	29,828,000	93,810	3,510,362	4,771,978	1,864,817
1992–93	31,314,000	115,534	5,211,484	5,195,777	1,823,586
1995–96	31,963,000	141,017	5,439,732	5,467,224	1,636,641
1998–99	33,419,000	162,064	5,066,575	5,844,111	1,776,401
2001–02	35,361,000	157,979	6,162,782	6,147,375	2,168,949
2004–05	36,899,000	164,179	6,558,873	6,322,141	2,119,773
2007–08	38,148,000	170,973	6,685,969	6,275,469	2,268,261
Percent Increase	**28%**	**82%**	**90%**	**32%**	**22%**

Sources: Department of Finance's Demographic Research Unit's population estimates; California Department of Corrections and Rehabilitation, reports prepared by its Offender Information Services Branch; Department of Education's enrollment reports prepared by the Educational Demographics Office; Department of Health Care Services, Medical Care Statistics Section; and California Postsecondary Education Commission higher education enrollment reports for the fall of each fiscal year.

Note: This table shows data for every third fiscal year.

Additionally, voters have approved ballot measures that add programs and projects but do not identify specific funding sources. Instead, these programs and projects are often financed with bonds that must be repaid over time from the General Fund. For example, in fiscal year 2007–08, according to Finance, the General Fund made debt-service payments for general obligation bonds of

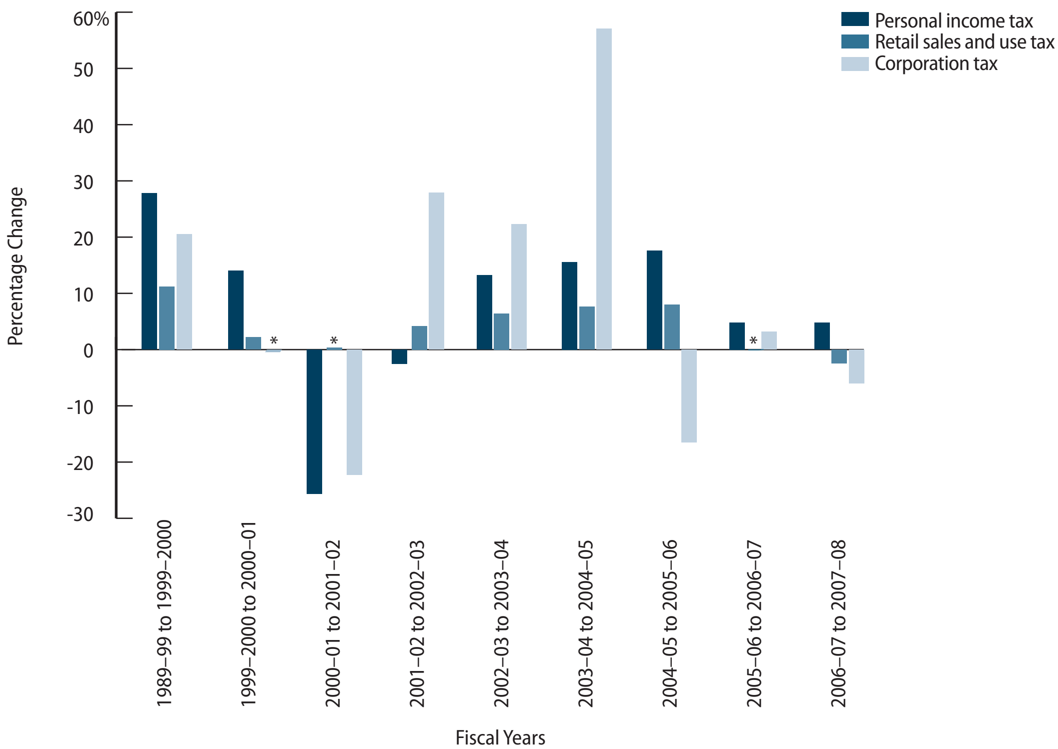
$3.2 billion, and it estimates that these payments will rise to $4.9 billion in fiscal year 2009–10. Despite the burden these payments will place on future state budgets, California voters continue to authorize the issuance of large amounts of general obligation bonds through ballot measures. The California Constitution generally requires voter approval of general obligation bonds, whether proposed by the Legislature or by voters. Voter approval of these bonds obligates the General Fund to use its major revenue sources such as personal income, sales, and corporate income taxes to pay the principal and interest on the debt. In the last 10 years, voters have approved roughly $105 billion in general obligation bonds. In addition to repaying the principal, the State could pay as much as $98 billion in interest on these bonds.

In the last 10 years, voters have approved roughly $105 billion in general obligation bonds—the State could pay as much as $98 billion in interest on these bonds.

Another factor causing budgetary problems is that the State's revenue structure, which depends to a large degree on personal income taxes, is very sensitive to changes in the economy. For instance, the General Fund depends on tax revenue streams that fluctuate more from year to year than other types of tax revenue, or even General Fund expenditures. This uncertainty makes effective budget planning difficult. Personal income tax, retail sales and use taxes, and corporation taxes account for more than 90 percent of General Fund revenues. Viewing the year-to-year changes as percentages shows more clearly the wide fluctuations in some portions of the General Fund revenues. As shown in Figure 2, the greatest one-year percentage increase in revenue from the corporation tax was 57 percent, and the greatest decrease was 22 percent, while the percentage change in personal income tax revenues ranged from an increase of 28 percent to a decrease of 26 percent. The yearly swings (whether negative or positive) in corporation and personal income tax revenues averaged 19 percent and 14 percent, respectively. Sales tax was less volatile, with an average of 5 percent in year-to-year change. The three tax sources combined averaged yearly swings of 11 percent.

Finally, because of various legal, political, business, and humanitarian considerations, it is difficult for decision makers to reduce expenditures to a level that will eliminate the ongoing deficits. These concepts are shown in Table 3 on page 16. For example, for fiscal year 2008–09, $41.9 billion or nearly 41 percent of the General Fund budget relates to expenditures that are mandated by the California Constitution. Additionally, another $22.9 billion or 22 percent relates to expenditures that secure federal funding and help support an underprivileged portion of the population. Although discretionary, other expenditures, such as those in support of the State's universities, represent investments in the future of California's economy that would be difficult, if not unwise, to

Figure 2
Year-to-Year Percentage Change in Significant General Fund Revenue Sources
Fiscal Years 1998–99 Through 2007–08



Source: *General Fund Cash Basis Reports*, published by the State Controller's Office.
* The percentage change for this period is less than 1 percent.

significantly reduce. Table 3 on the following page presents the results of our classification of the fiscal year 2008–09 budget into various categories that represent the type of constraints limiting lawmakers' discretion. A more detailed description of the constraints impacting the budget can be found in our February 2009 report.

The combination of all these factors has created a situation in which resolving the State's budget problems will not be easy. The Bureau has added the state budget to its list of high-risk issues because we recognize that it is an issue that will likely continue to affect the state government's ability to effectively carry out its mission. We will continue to monitor developments related to the state budget and will attempt to help decision makers find areas where expenses could be streamlined or revenues increased.

Table 3
Enacted General Fund Budget Categorized by Various Constraints
Fiscal Year 2008–09
(in Billions)

AGENCY CATEGORY/DEPARTMENT	AGENCY LEVEL	DEPARTMENT LEVEL	CONSTITUTIONALLY MANDATED	FEDERAL LIMITATIONS ON DISCRETION	SECURES FEDERAL FUNDING	LEGISLATIVE DISCRETION	NOT REVIEWED
K-12 Education	$41.6		$37.6				$4.0
Higher Education	12.1						
California Community Colleges		$4.3	4.3				
University of California		3.3				$3.3	
California State University		3.0				3.0	
Other		1.5					1.5
Health and Human Services	31.1						
Department of Health Care Services		14.8			$13.6	1.2	
Department of Social Services		9.9			7.9	2.0	
Department of Developmental Services		2.8			1.4	1.4	
Other*		3.6					3.6
Corrections and Rehabilitation	10.3			$2.3		6.4	1.6
Other agency categories	8.3						8.3
Totals	**$103.4**		**$41.9**	**$2.3**	**$22.9**	**$17.3**	**$19.0**

Source: Bureau of State Audits' analysis of the enacted General Fund budget for fiscal year 2008–09.

* The other seven agency categories are Business, Transportation and Housing; Natural Resources; Environmental Protection; State and Consumer Services; Labor and Workforce Development; General Government; and Legislative, Judicial, and Executive.

California's System for Administering Federal Recovery Act Funds

Given the vast amount of federal funds that California expects to receive under the Recovery Act in the current and next fiscal year, the extensive requirements the Recovery Act places on recipients of these funds, the risk of California losing Recovery Act funds if it fails to comply with the requirements, and the existence of previously identified concerns related to certain state agencies' internal controls over their administration of federal programs, we believe that the State's system for administering the Recovery Act's funds is a statewide high-risk issue. As a result, to highlight this risk we issued a report in April 2009.[4]

The federal government enacted the Recovery Act to help fight the negative effects of the United States' economic recession. According to the Recovery Act, its purposes include preserving and creating jobs; promoting economic recovery; assisting those most affected by the recession; investing in transportation, environmental

[4] *California's System for Administering Federal Recovery Act Funds* (April 2009, 2009-611).

protection, and other infrastructure; and stabilizing state and local governmental budgets. The federal government intends to disperse approximately $787 billion to recipients, including states and local governments, under the Recovery Act.

The Recovery Act imposes significant requirements on entities that receive the funds and penalties for noncompliance. For instance, Section 1512(c) of the Recovery Act requires recipients to submit to the federal government a report containing several pieces of information not later than 10 days after the end of each calendar quarter. The act also mandates that as a condition of receiving funds, federal agencies will require recipients to provide this information. The required information includes the amount of recovery funds received, the amount of recovery funds spent or obligated, a detailed list of the projects on which recipients spent or obligated recovery funds, an estimate of the jobs created and the number of jobs retained by the project or activity, and the infrastructure investments made by the recipients. Further, Recovery Act funds must be spent quickly; for certain programs, these funds are available only until September 2010.

Latest developments:

The Bureau of State Audits has launched a new navigation link on our Web site that provides information about the American Recovery and Reinvestment Act of 2009 and our role in California's accountability. The various tables contain information regarding issues we noted in our audits of major federal programs in 2007 and 2008.

Source: Bureau of State Audits' Web site at www.bsa.ca.gov.

California stands to receive a large share of the funds being made available under the Recovery Act. According to the California Economic Recovery Portal (Recovery Portal), California's estimated share of the Recovery Act funds will be $85.4 billion, $30.2 billion of which will be in the form of tax relief to Californians. As of April 13, 2009, the Recovery Portal indicated that for fiscal years 2008–09 and 2009–10, $29 billion will go to state entities or be shared among state entities and non-state entities to implement the Recovery Act's provisions. Another $5.8 billion will be split among federal and non-state entities. It has not yet been determined which state or local entities will receive the remaining $11.2 billion. The Recovery Portal indicates that 14 state entities could receive Recovery Act funds in fiscal year 2008–09, at least three of which are expected to receive over $300 million each.

Given the large amount of funds that California expects to receive under the Recovery Act and the significant requirements imposed by the act, we examined prior audit reports to see whether they identified concerns related to internal controls. We examined the fiscal year 2006–07 Single Audit report we issued and pertinent audit reports that state entities issued under the Financial Integrity and State Manager's Accountability Act of 1983 (FISMA). According to Finance, the FISMA was enacted to reduce the waste of resources and strengthen accounting and administrative control.

State law requires certain state agencies to conduct an internal review and prepare a report on the agency's internal accounting and administrative controls every two years.

As shown in Table 4, we identified 46 findings in the fiscal year 2006–07 Single Audit report that related to internal controls over federal funds for the state entities shown. Two of the entities shown in Table 4—the Secretary of Education and the Office of Planning and Research—did not administer federal grants that we audited as part of the Single Audit for fiscal year 2006–07. Examples of internal control findings we reported included the Employment Development Department did not follow the U.S. Department of Labor's instructions for reporting training costs for one of its federal programs and could not demonstrate the accuracy and completeness of the information it received from its field offices that was used to calculate several figures ultimately reported to the federal government.

Table 4
Internal Control Findings for State Entities Expected to Receive in Excess of $300 Million in Funds From the American Recovery and Reinvestment Act of 2009 by the End of Fiscal Year 2008–09

	AMOUNT OF RECOVERY ACT FUNDS THE STATE EXPECTS CERTAIN ENTITIES TO RECEIVE (IN MILLIONS)*	AREA WHERE THE INTERNAL CONTROL FINDING WAS IDENTIFIED					TOTAL NUMBER OF FINDINGS
		ACTIVITIES ALLOWED/ ALLOWABLE COSTS	CASH MANAGEMENT	ELIGIBILITY	REPORTING	SUBRECIPIENT MONITORING	
Department of Social Services	$332.4	2	0	0	0	2	4
Employment Development Department	1,800.5	2	0	1	2	0	5
Department of Health Care Services	3,286.9	6	0	5	2	2	15
Secretary of Education, Department of Finance, and Office of Planning and Research†	5,202.5	2	6	1	6	7	22
Totals	**$10,622.3**	**12**	**6**	**7**	**10**	**11**	**46**

Sources: Bureau of State Audits' (Bureau) Internal Control and State and Federal Compliance Audit Report for the fiscal year ended June 30, 2007. We obtained dollar amount information from the California Economic Recovery Portal as of April 13, 2009.

* The dollar amounts shown here include only those amounts expected to be provided directly to the state entities or to be shared between state entities and non-state entities.

† The Bureau did not review federal grants administered by the Secretary of Education or the Office of Planning and Research for fiscal year 2006–07. The internal control weaknesses in this row include one cash management finding at the Department of Finance and 21 findings at the California Department of Education (Education). We included Education's findings in this row because it appears likely that it will be involved in administering a significant portion of the $5.2 billion expected for these state entities.

Similarly, for a federal program at the Department of Health Care Services, we reported that business users (who did not have any system administration responsibilities) had full, unrestricted administrative access to a database used by the program. We determined that administrative users had the ability to change data and disable any controls on the system, thereby removing the ability to trace actions of the user.

We also noted internal control concerns raised as part of the FISMA reviews. For instance, the FISMA report for the Department of Social Services stated that the department, among other weaknesses, had inefficient and costly internal controls over cash receipts, lacked a comprehensive information technology solution to manage accounts receivable and cash receipts, and was late in recording manual cash disbursements.

Because of the concerns related to internal controls, the large amounts of Recovery Act funds California is expected to receive, the requirements the federal government is imposing on recipients, and the limited time the State has to spend some of the funding, we designate California's system for administering federal Recovery Act funds as a statewide high-risk issue. Thus, we will exercise the Bureau's authority to initiate audits of issues of high risk and conduct a review of the State's and selected departments' readiness to comply with applicable federal Recovery Act requirements.

Due to internal control concerns, the large amounts of Recovery Act funds anticipated, additional federal requirements tied to the funds, and the limited time the State has to spend the funds, California's system for administering Recovery Act funds is of high risk.

Production and Delivery of Electricity

Because California's electricity sector faces multiple challenges and problems related to energy production and consumption, the Bureau has added the production and delivery of electricity to its list of issues that pose a high risk to the State and its citizens.[5] The reliable supply of electricity provides a critical foundation both for California's economy and its citizens' standard of living. The electricity industry is evolving to address problems highlighted by the energy crisis of 2000 and 2001 while simultaneously working to introduce mechanisms to increase competition and to support the State's overall energy targets. Since the energy crisis, the State has continued to deal with the challenges of ensuring that sufficient capacity exists to generate the volume of electricity needed, that California has the infrastructure necessary to transport the electricity to the areas that most need it, and that the appropriate regulatory agencies work collaboratively in their efforts to ensure that an energy crisis does not reoccur.

In 1996, when the State took the lead in the national move toward restructuring the electricity industry to allow for greater competition, proponents assumed that these actions would reduce California's electric rates. Despite this intent, the State experienced rolling blackouts and, in January 2001, the governor proclaimed a state of emergency. Wholesale electricity prices escalated to unprecedented levels. Because of a cap on retail prices, two of the

5 *High Risk: The California State Auditor Has Designated Electricity Production and Delivery as a High-Risk Issue* (June 2009, 2008-602).

State's three largest electricity providers—Pacific Gas and Electric Company (PG&E) and Southern California Edison—could not recoup their costs from customers and PG&E ultimately filed for bankruptcy.

By many accounts, several interconnected events during the early part of the current decade contributed to the energy crisis. For instance, the State and energy providers did not meet increased demand for electricity with investments in new generation of electricity or in upgrades to the State's system for transmitting electricity. Compounding this imbalance, a flawed market design relied too heavily on short-term markets, leaving participants overexposed to market manipulation that led to high wholesale prices. Because of the uncertainty related to the ability of the large electricity providers to secure enough electricity supplies to meet their customers' needs, the State took steps to alleviate the crisis, including procuring long-term power contracts to ensure both a reliable supply of electricity and rate stability.

Since the energy crisis of 2000 and 2001, the electricity sector has continued to evolve. In fact, industry observers suggest that the actions the State has taken have expanded energy infrastructure and decreased the risk of another energy crisis. For example, state regulators began ensuring that providers procured enough electricity to meet demand forecasts. Market participants also took actions to bring more electricity generation online in California, to improve the transmission system to reduce congestion, which occurs when electricity providers have scheduled more electricity to flow across a certain transmission path than lines could transmit, and to implement programs to reduce electricity usage, especially during times of the day when electricity use and rates are highest.

New Power Plants and Transmission Upgrades

Megawatt:

One megawatt equals 1 million watts or 1,000 kilowatts, which is enough electricity to meet the instantaneous demand of roughly 750 homes at once. (The number of homes fluctuates because electricity demand changes based on the season, the time of day, and other factors.)

Source: California Independent System Operator's Web site at www.caiso.com.

Significant additions in the energy infrastructure have taken place since the energy crisis that helps to reduce the risk that another energy crisis may occur. However, what was gained in electricity supplies by building new power plants during the last 10 years may be somewhat offset by the need to replace environmentally harmful and aging power plants in the near future and by the difficulties that the State faces in doing so.

During the last decade the California Energy Commission (Energy Commission), the State's primary energy policy and planning agency, has approved new power plants. According to the Energy Commission's reports on the status of energy facilities, as of May 2009, it had approved 69 power plants. These approved plants have the capacity to produce more than 25,000 total megawatts of power; however, as of May 2009, only 42 of these power plants were online. See the text box for the definition of a megawatt. As Table 5 indicates, the facilities brought online have the capacity to produce just over 14,200 total megawatts. Although energy providers have retired some power plants, the increase in megawatts brought online has resulted in roughly 9,200 megawatts of power available to meet electricity demands. Further, according to the Energy Commission's reports on the status of energy facilities as of May 2009, power plants currently under construction will have the capacity to generate nearly 2,400 megawatts. An additional 6,600 megawatts could be generated from approved plants for which construction has not begun or is on hold due to unfavorable markets or unavailable financing. Additionally, power plants with applications pending before the Energy Commission could have the capacity to produce over 10,500 megawatts if approved and placed online.

Table 5
Maximum Generating Capacity of California Power Plants Brought Online or Retired From 1998 Through 2009

YEAR	MEGAWATTS BROUGHT ONLINE	MEGAWATTS RETIRED*	NET CHANGE IN MEGAWATTS
1998	0	1	(1)
1999	0	56	(56)
2000	0	1	(1)
2001	1,914	39	1,875
2002	2,504	807	1,697
2003	3,893	2,122	1,771
2004	0	328	(328)
2005	2,584	1,320	1,264
2006	2,015	219	1,796
2007	177	0	177
2008	93	0	93
2009†	1,050	0	1,050
Totals	**14,230**	**4,893**	**9,337**

Source: The California Energy Commission's (Energy Commission) energy facility status reports as of May 2009.

* According to the Energy Commission, *retired* generally refers to generation from those plants that will never come back online (that is, components of the plant have been disassembled and removed for resale or scrap).

† The data presented for calendar year 2009 represents megawatts brought online or retired through May 1, 2009.

According to the director of the California Independent System Operator's (ISO) department of market monitoring (monitoring director), California has made significant strides in adding to its electricity infrastructure since the energy crisis. For example, the monitoring director explained that from the end of the energy crisis in 2001 through 2007, the ISO gained approximately 15,800 megawatts to its *balancing authority area,* or the region in which it has the authority to balance the electricity flow across transmission lines. This figure represents an increase of approximately 39 percent over the 41,000 megawatts of estimated available generation in 2000. Additionally, the monitoring director concluded that new electricity generation throughout the West provides additional opportunities for California to import power when needed to meet peak demands. Further, in its 2008 *Annual Report on Market Issues and Performance,* the ISO projects that generation additions in Southern California will just keep pace with consumer demand and unit retirements. However, after the ISO accounts for consumer demand and unit retirements, it forecasts that Northern California will see a larger increase in new electricity generation. Thus, the supply shortages that contributed to the energy crisis in 2000 and 2001 are not as likely to reoccur.

In 2004 and 2005, utilities completed upgrades to the main transmission lines that allow electricity to move between California's southern and northern regions—regions that experienced blackouts during the energy crisis.

According to the ISO, in addition to the construction of new power plants, improvements to California's key transmission lines are complete. The ISO's monitoring director noted that the capacity on frequently congested transmission lines in the ISO's balancing authority area has increased by approximately 4,600 megawatts. Notably, in 2004 and 2005, utilities completed upgrades to the main transmission lines that allow electricity to move between California's southern and northern regions—regions that experienced significant congestion during the energy crisis, thus causing blackouts.

Electricity Programs and Supply

Because development of electricity-generating capacity must consider peak demand and because the addition of new system capacity is time-consuming and expensive, state entities and other participants in the electricity market are also working to implement programs, such as conservation and energy efficiency rebates, to reduce electricity usage. In particular, the Energy Commission, the ISO, and the California Public Utilities Commission (CPUC) aim to reduce usage during *peak demand periods,* or the hours when most consumers use electricity and when electricity costs are highest. To accomplish this goal, both investor-owned and municipal utilities offer *demand response programs* (demand response) that provide incentives to businesses and consumers when they reduce their consumption when asked during certain periods. Both the Energy

Commission and the CPUC agree that demand response can reduce electricity use during peak periods when the least efficient generation occurs, which may thereby reduce greenhouse gas and other air emissions. Additionally, according to the CPUC, it has set timetables to introduce dynamic pricing programs that reflect high and low periods of usage for large commercial and industrial customers. In fact, according to the Energy Commission, the State has a goal of reducing peak usage by 5 percent through the use of demand response.

Aging and environmentally harmful power plants that supply a significant portion of California's electricity capacity may need to undergo expensive retrofittings or shut down.

Although the State and other market participants continue to work to resolve the issues that prompted the energy crisis and further refine actions taken to alleviate a reoccurrence, significant new issues and challenges in the electricity sector have the potential to influence the supply of electricity, its transmission, and consumer rates. For example, although the State is working to increase electricity generation and transmission, aging and environmentally harmful power plants that supply a significant portion of California's electricity capacity may need to undergo expensive retrofittings of their cooling systems or shut down. At the same time, various issues may delay or prevent the construction of new power plants or updates to existing plants. The uncertainty about the power plant owners' ability or desire to replace the environmentally harmful cooling systems at existing power plants poses a high risk to the State because the loss of electricity supplies could compromise the reliability of electrical services. In particular, Southern California may bear the greatest burden because many of the aging and environmentally harmful power plants that may be forced to retrofit or close are in that region, and it lacks adequate transmission capacity to allow the import of sufficient electricity from other sources on peak demand days. Nonetheless, a recent court order required the South Coast Air Quality Management District to halt certain activities to enable new power plant construction and upgrades in this region.

In addition, as the State's power contracts expire, efforts are currently underway to return all responsibility for supplying electricity to the investor-owned utilities, about five years prior to the expiration of the last of the State's long-term contracts. Although the utilities have been able to secure sufficient supplies of electricity through their own contracts to meet the balance of their customers' demand, there is still uncertainty as to whether the utilities will continue to be in a position to secure an adequate supply. Further, efforts led by a group representing electricity suppliers and various private and public electricity consumers to again allow direct access—an option that enables customers to choose an electricity provider other than their default utility—creates additional uncertainty within the electricity market.

Renewable Resource Targets

Since the energy crisis, California has adopted targets to increase the use of renewable sources of electricity. However, the State is at risk of failing to meet these targets because various obstacles are preventing the construction of the infrastructure needed to generate and transmit electricity from such renewable sources as wind and solar. To help increase the total production of renewable electricity statewide, the State adopted a renewables portfolio standard. Moreover, the Legislature established a target of generating 20 percent of California's total retail sales of electricity from renewable energy resources by December 31, 2010. According to the Energy Commission, in 2007 roughly 12 percent of the State's electricity was supplied by renewable sources. Additionally, the governor recently announced a more aggressive target, increasing the target to 33 percent by 2020. However, the State needs to overcome a number of barriers before it can meet either of these targets.

The State may fail to meet targets to increase the use of renewable sources of electricity because of a number of barriers including difficulties with siting and constructing renewable electricity generators, such as wind and solar facilities.

According to the Energy Commission, some of the difficulties that the State faces in meeting its renewable energy targets include those involving the siting and construction of renewable electricity generators, such as wind and solar facilities. For example, according to the federal Bureau of Land Management (BLM), large solar thermal power plants require many acres of land to gather sufficient radiant energy. The BLM anticipates that new solar power plants may require an average of at least 500 acres to produce 100 megawatts of electricity. Additionally, the amount of sunlight reaching the earth's surface is affected by the season, time of day, climate, and air pollution. Information from the National Renewable Energy Laboratory, which is part of the U.S. Department of Energy, indicates that the Mojave Desert's potential for the siting of solar power plants is as great as or greater than that of any other region in the country. However, according to Energy Commission documents, the transmission infrastructure serving the area requires expansion. According to the CPUC, it has approved several new transmission lines to facilitate the delivery of renewable energy to consumers, and others have been proposed.

Associated with the issue of constructing renewable energy generation facilities in remote areas, as the Energy Commission points out, is the complex regulation of the construction of new transmission lines. In particular, the agencies that provide regulatory approval and oversight for constructing the lines can vary depending on where the lines are located. For example, different federal agencies have permitting oversight for long-distance transmission lines depending on what federal land the proposed facilities will be built. Additionally, the ISO must approve the interconnection of any new power-generating facilities to the electric grid—the infrastructure of transmission lines through which electricity is delivered to homes and businesses—within its control area. Each of these entities may apply different criteria to the process before granting their approval.

Several other barriers exist that could affect the development of renewable energy sources. For example, according to the Energy Commission, the demand for electricity can vary throughout the day as well as by season. To some extent, these variations determine the type of renewable energy sources that are most feasible. For instance, according to information from the Energy Commission, wind generation can peak at various times of the day or night, depending on the season and location. These peak times may not coincide with peak demand, which occurs in midafternoon to early evening. Solar power offers an attractive approach to help meet the demand for electricity, because its period of greatest availability roughly coincides with the timing of California's peak demand. However, according to the Energy Commission, to help ensure that the electric grid does not fail, local reliability requirements often necessitate that electricity be generated close to demand areas. As we just discussed, however, many of the renewable energy sources would likely be constructed in remote locations. Additionally, the process for approving new generation can take more than a year and, according to the Energy Commission, an influx of new and less-experienced developers who may not understand the complex project development process might contribute to the difficulty in licensing new generation facilities. As a result of these and other factors, siting and constructing renewable generation can be a difficult process.

The process for approving new generation can take more than a year.

All of these barriers play a role in whether and when California can meet its renewable energy targets. In the 2008 update to the Energy Action Plan, the Energy Commission and the CPUC point out that the State will likely not achieve the target of generating 20 percent of California's total retail sales of electricity from renewable energy resources by 2010. However, state agencies that are responsible for regulating California's energy infrastructure have begun taking steps toward overcoming these barriers. For instance, in November 2008 the governor signed an executive order that established a Renewable Energy Action Team to create a one-stop process for permitting renewable energy facilities. Another example of action by state agencies is the Renewable Energy Transmission Initiative (RETI), a statewide initiative to facilitate and coordinate the planning and permitting of transmission and generation projects needed to make progress toward the State's renewable policy targets. According to the Energy Commission's Web site, the Energy Commission, the CPUC, the ISO, and three publicly owned utilities are coordinating the RETI effort. Additionally, the ISO has created an Integration of Renewable Resources Program to foster the integration of renewable resources into the electric grid.

Finally, it is too early to tell whether modifications to the market structure—such as the reinstatement of energy markets that failed at the height of the energy crisis; a new wholesale electricity pricing scheme; and the use of a new computer model of the electric grid that will allow, for example, better identification of transmission bottlenecks—will continue to succeed. Further, adding to the issues described above is a proposal currently before the Legislature to reorganize certain energy-related entities and create a new state Department of Energy, which presents additional uncertainties related to the State's ability to formulate strategic energy policies.

Consequently, we believe that our list of high-risk issues should include energy concerns and, more specifically, the areas related to supplying electricity to California's citizens. We will continue to monitor new developments and challenges that affect the industry as well as their effects on the reliability and affordability of electricity. To the extent that resources are available, the Bureau may undertake future projects that could include recommendations to improve electricity-related policies and programs and how best to implement those improvements. For example, the Bureau may monitor developments in a court ruling regarding a proposed policy that potentially affects electricity supplies in Southern California. The Bureau may report on the status of the State's expiring energy contracts and the ability of large electricity providers to procure sufficient energy supplies to meet consumers' needs. Also, should major developments occur, the Bureau may consider deeper evaluations of the new market structure, the State's ability to meet its renewable resource targets, and, if one is created, the effectiveness of a new state Department of Energy.

Chapter 2

AN IN-DEPTH REVIEW OF SELECT ISSUES OF CONTINUING HIGH RISK

Chapter Summary

The issues of continuing high risk discussed in this chapter are maintaining and improving infrastructure, human resources management, and other postemployment benefits of retiring state employees. The Bureau of State Audits (Bureau) completed in-depth reviews of these three issues, and as the text box indicates, published separate reports on each issue.

The following Bureau of State Audits' reports highlight select issues of continuing high risk:

- *High-Risk Update—Maintaining and Improving Infrastructure: State Agencies Have Established Controls That, if Followed, Should Provide Reasonable Assurance That Infrastructure Bond Proceeds Are Used as Intended* (February 2009, Report 2008-604)
- *High-Risk Update—Human Resources Management: A Significant Number of State Employees Are Beginning to Retire, While Certain Departments That Provide Critical State Services Lack Workforce and Succession Plans* (March 2009, Report 2008-605)
- *High-Risk Update—Other Postemployment Benefits: Significant Financial Risk Exists if the State Does Not Actively Manage the Costs of State Retirees' Health and Dental Benefits* (April 2009, Report 2008-607)

Source: Bureau of State Audits' Web site at www.bsa.ca.gov.

Our February 2009 report indicated that, according to the Governor's Office, the State's infrastructure is showing its age and is under increasing strain due to the State's economic activity and population. California's plan to rebuild its infrastructure indicates that the State needs over $500 billion in infrastructure investment to meet the needs of a growing population over the next 20 years. Our review found that administering agencies had committed about $25 billion of $42.7 billion in bonds authorized by the voters to specific infrastructure projects and that the agencies had actually spent about $7.3 billion. The governor has established a framework for infrastructure bond accountability that, if followed, should provide reasonable assurance that infrastructure bond proceeds are used as intended. However, the Department of Finance (Finance) and the agencies that administer the bond proceeds have not implemented all of the requirements of an executive order requiring that state agencies establish, and submit to Finance, an accountability plan for each program receiving bond proceeds.

Our March 2009 report noted that the State is facing the retirement of a significant number of today's workers in both leadership and rank-and-file positions. Although these employees are near or at retirement age, it is unknown how the developments in the worldwide financial markets and the State's budgetary problems will affect state employees' retirement decisions, but planning for these retirements is prudent to ensure continued delivery of state services. The Department of Personnel Administration (Personnel Administration) has focused much of its efforts on workforce planning and on modernizing and streamlining the State's human resource system to recruit, develop, and maintain a well-qualified and high-performing workforce. However, California has been late to the table in addressing its succession planning needs because it does not require departments to develop workforce and succession plans.

Finally, our April 2009 report indicated that the costs of other postemployment benefits, commonly referred to as OPEB, will continue to be a high-risk issue for the State as long as it continues to use the pay-as-you-go method of funding these costs. As of June 30, 2008, the estimated future cost of retiree health benefits that state employees have already earned had exceeded $48 billion. Most governments prefund the future costs of pensions, establishing dedicated trust funds in which they deposit money to finance the anticipated costs of pensions for current and past employees. In contrast, many governments, including California, appropriate only enough money in their annual budgets to pay the yearly premiums for retiree health (medical and dental) insurance. Under new accounting rules for government financial statement reporting addressing the extent to which the liability for such costs should be recognized, the State's projected OPEB liability by June 30, 2009, will be $4.71 billion. With a growing unfunded OPEB liability, the State may be risking its credit rating.

Maintaining and Improving Infrastructure

In January 2006 the governor and legislative leaders launched a 20-year plan, the *California Strategic Growth Plan* (strategic growth plan), to rebuild California's infrastructure. The State's infrastructure covers a myriad of assets, including roads, bridges, levees, housing, schools, government buildings, prisons, parks, and health facilities. Much of the State's infrastructure was constructed in the 1950s and 1960s. According to the Governor's Office, the State's infrastructure is showing its age and is under increasing strain due to the State's economic activity and population. The January 2007 update to the strategic growth plan indicated that California needs over $500 billion in infrastructure investment to meet the needs of a growing population over that time span. In the November 2006 general election, the voters approved $42.7 billion in bonds to partially fund the State's plan to rebuild California's infrastructure. To provide a framework for infrastructure bond accountability, in January 2007 the governor issued Executive Order S-02-07 (executive order), which includes a requirement that state agencies establish, and submit to Finance, a three-part accountability plan for each program they administer that is receiving bond proceeds. Further, the executive order outlined oversight responsibilities for state agencies and Finance, including developing and maintaining a bond accountability Web site

(Web site). In our February 2009 report,[6] the Bureau reported on the State's efforts to manage the risks associated with administering those bonds.

During our review, we found that the administering agencies have committed about $25 billion of the $42.7 billion authorized by the voters to specific infrastructure projects and that the agencies have actually spent about $7.3 billion. The text box shows the bond acts approved by the voters in November 2006 and associated expenditures as of June 30, 2008. We also found that the governor's executive order, if followed, should provide reasonable assurance that the administering agencies spend the proceeds effectively, efficiently, and as intended by the voter-approved ballot measures. However, Finance and the agencies that administer the bond proceeds (administering agencies) have not fully implemented the requirements of the executive order. Although most submitted accountability plans for each of their programs, administering agencies had not submitted, nor had Finance approved, accountability plans for nine of the 105 programs listed on Finance's Web site as of December 2008. According to Finance, it has since approved four of the nine plans. In addition, Finance has not fully implemented a process to conduct audits of completed projects—however, few projects have been completed. Also, Finance has not monitored the Web site to ensure administering agencies update it as required. Some administering agencies are not posting timely updates to the Web site. For example, the Department of Water Resources (Water Resources) did not post 32 projects totaling $535 million funded by voter-approved propositions. Further, the Department of Fish and Game did not list separately the amounts committed for three programs. Finally, all six administering agencies we reviewed have designed controls that, if followed, are adequate to provide reasonable assurance that infrastructure bond proceeds are awarded to eligible entities for eligible projects and that those entities use the bond proceeds appropriately for approved infrastructure projects.

November 2006 Infrastructure Bonds and Associated Expenditures as of June 30, 2008 (in Thousands)

Proposition 1B: Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006	$2,895,115
Proposition 1C: Housing and Emergency Shelter Trust Fund Act of 2006	$992,827
Proposition 1D: Kindergarten—University Public Education Facilities Bond Act of 2006	$2,689,160
Proposition 1E: Disaster Preparedness and Flood Prevention Bond Act of 2006	$265,352
Proposition 84: Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006	$479,670

Sources: November 2006 general election propositions and Department of Finance.

[6] *High-Risk Update—Maintaining and Improving Infrastructure: State Agencies Have Established Controls That, if Followed, Should Provide Reasonable Assurance That Infrastructure Bond Proceeds Are Used as Intended* (February 2009, Report 2008-604).

Components of the Accountability Plans Required by the Governor's Executive Order

Front-end accountability: Each administering agency shall follow criteria and processes to govern the expenditure of bond funds and the outcomes that the expenditures are intended to achieve.

In-progress accountability: Each administering agency shall document the ongoing actions it will take to ensure that the projects or other activities funded by the bond proceeds are staying within their approved scope and cost.

Follow-up accountability: All expenditures of bond funds are subject to audit to determine whether the expenditures were made according to the established front end criteria and processes, were consistent with all legal requirements, and achieved their intended outcomes.

Source: Governor's Executive Order S-02-07.

The Governor's Executive Order

The executive order the governor issued in January 2007 laid a framework for bond accountability. The order requires state agencies to establish a three-part accountability plan for each program receiving bond proceeds and to submit the plans to Finance by March 1, 2007, for review of the reasonableness of the plan and consistency with the requirements of the executive order. Additionally, the executive order generally prohibits any administering agency from spending infrastructure bond proceeds for a program until Finance has determined the program's bond accountability plan is adequate. The text box shows the components of an accountability plan.

The requirements of the executive order, if followed, should provide reasonable assurance that administering agencies will be accountable for ensuring that bond proceeds are spent efficiently, effectively, in the best interests of the people of the State of California, and in a manner consistent with the provisions in the respective bond act as well as all applicable state and federal laws.

The executive order requires Finance to create a Web site containing information on how infrastructure bond proceeds are being used so that the public can readily access this information. The bond accountability Web site is to include the three-part accountability plan for the programs of each administering agency; a list of all projects, programs, or other authorized activities funded under the provisions of each general obligation bond act; and the amounts expended for each project. In addition, Finance is required to include on this Web site the actions administering agencies are taking to ensure that projects remain within the approved scope and cost and the results of completed projects or activities funded by infrastructure bond proceeds. The administering agencies are required to provide Finance with the information necessary to support this Web site.

Implementation of the Executive Order

Finance and the administering agencies have made progress toward implementing bond accountability, however, work remains to achieve the goals of the executive order. For example, in accordance with the executive order, Finance reviews and approves the three-part accountability plans the administering agencies submit, thus allowing these agencies to expend bond funds. Finance has developed a checklist for reviewing the accountability plans the administering agencies submit to ensure that the plans meet the requirements of the executive order. The checklist has three main sections and incorporates the various requirements imposed by the executive order. For example, the section on front-end accountability addresses criteria, performance standards, and outcome measures, as well as compliance and reporting. The section on in-progress accountability addresses the administering agency's monitoring and reporting efforts. The section on follow-up accountability covers the administering agency's internal audit procedures and its process for conducting external audits. After Finance approves a plan, it posts the plan on the bond accountability Web site.

Latest developments:

The American Recovery and Reinvestment Act of 2009 (Recovery Act) is federal law aimed at stimulating state and local economies as well as stabilizing these governmental budgets through various measures, including the provision of funds for infrastructure. As of April 2009, the State estimated it would receive $4 billion in Recovery Act funds for transportation needs such as highways, roads, and bridges.

Source: California Economic Recovery Portal at http://recovery.ca.gov.

The executive order prohibits administering agencies from spending bond proceeds until Finance has approved the program's accountability plan or, under certain circumstances for established programs, has extended the deadline. However, as of December 12, 2008, Finance had not approved accountability plans or granted extensions for nine of the 105 programs that were listed on the Web site. Finance stated that four of the nine plans were formally approved subsequent to our December 12 review. In fact, the Web site listed the four as being approved as of February 9, 2009. Finance also indicated that the administering agencies for three of the remaining five programs have posted guidelines to the Web site that address in detail criteria for determining a proposed project's eligibility for funding as well as the reporting and monitoring efforts associated with a project. According to Finance, the agencies for the remaining two programs are currently developing their accountability plans; however, these agencies have not approved or funded any projects.

We asked Finance why bond funds were expended for seven of the nine programs when they did not have approved accountability plans. Finance stated that the seven programs had control mechanisms in place that would be found in a formally written accountability plan, such as guidelines for awarding grants of bond funds, and it indicated that, although formal plans were not posted to the bond accountability Web site before bond funds were expended, Finance believes the agencies that administer the programs had addressed bond fund accountability. We reviewed the management controls established for one of these programs by the Department of Transportation (Transportation), which is responsible for the projects funded by Proposition 1B under the Public Transportation Modernization, Improvement, and Service Enhancement Account, and found that Transportation has designed adequate controls to provide accountability. In fact, by February 9, 2009, the Finance-approved accountability plan for the program had been posted to the Web site. Table 6 shows the various

Table 6
Status of Bond Accountability Plans for November 2006 Infrastructure Bonds as of December 12, 2008

PROPOSITION	ADMINISTERING AGENCIES (TOTAL OF 30*)	TOTAL PROGRAMS EACH AGENCY ADMINISTERS	PROGRAMS WITH THREE-PART ACCOUNTABILITY PLANS	
			APPROVED	NOT YET APPROVED
1B—Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006	Air Resources Board	2	2	-
	California Transportation Commission (Commission)	9	4	5†
	Department of Finance (Finance)	1	-	1†
	Department of Transportation (Transportation)	2	-	2†
	Governor's Office of Homeland Security	2	2	-
1C—Housing and Emergency Shelter Trust Fund Act of 2006	California Housing Finance Agency	1	1	-
	California Pollution Control Financing Authority	1	-	1
	Housing and Community Development	12	12	-
1D—Kindergarten—University Public Education Facilities Bond Act of 2006	California Community Colleges and its Board of Governors	1	1	-
	California State University	1	1	-
	State Allocation Board	7	7	-
	University of California	1	1	-
1E—Disaster Preparedness and Flood Prevention Bond Act of 2006	Department of Water Resources (Water Resources)	8	8	-
84—Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006	Baldwin Hills Conservancy	1	1	-
	California Conservation Corps	1	1	-
	California Department of Forestry and Fire Protection	1	1	-
	California State Parks	3	3	-
	California Tahoe Conservancy	1	1	-
	Coachella Valley Mountains Conservancy	1	1	-
	Department of Conservation	1	1	-
	Department of Fish and Game	5	5	-
	California Department of Public Health	4	4	-
	Water Resources	15	15	-
	San Gabriel and Lower Los Angeles Rivers and Mountains Conservancy	2	2	-
	San Joaquin River Conservancy	1	1	-
	Santa Monica Mountains Conservancy	2	2	-
	Secretary for Resources	2	2	-
	Sierra Nevada Conservancy	1	1	-
	State Coastal Conservancy	6	6	-
	State Water Resources Control Board	4	4	-
	Wildlife Conservation Board	6	6	-
Totals		**105**	**96**	**9**

Source: Finance's bond accountability Web site.
* Because Water Resources administers programs authorized by two propositions, it is included twice on the table.
† Subsequent to December 12, 2008, Finance approved the accountability plan for the one program it administers, two program plans administered by Transportation, and one program plan administered by the Commission.

administering agencies for each of the bonds California voters approved in November 2006, the number of programs each agency is responsible for, and how many of those programs had approved accountability plans as of December 12, 2008.

Finance has not yet begun conducting required audits of completed projects. The third section of each accountability plan addresses follow-up accountability and requires administering agencies to contract with Finance for audits of the use of bond proceeds upon project completion, or to obtain Finance's approval for alternative audit arrangements. These audits are to ensure that such expenditures conform with front-end criteria, and are consistent with legal requirements, and achieve the intended outcomes. According to officials at Finance, as of January 2009, little of this audit work had been done because few, if any, projects had been completed. However, Finance is currently developing audit procedures, and it plans to begin conducting audits in fiscal year 2009–10.

As required by the executive order, Finance has established a bond accountability Web site intended to provide public access to information on how proceeds from the State's general obligation and lease revenue bonds, including the infrastructure bonds, have been spent. According to Finance, the administering agencies are responsible for updating the project information on the Web site, and Finance expects the agencies to do so at least semiannually, by June 30 and January 1 of each year.

We found that the bond accountability Web site does not list all of the programs or projects funded by the infrastructure bonds, as required by the executive order. When searching the Web site for the bond funds committed to the programs authorized by the propositions, we noted that Water Resources posted overall commitments of bond proceeds but did not break the commitments down by program for 10 of the programs authorized by Propositions 1E and 84. Further, we noted that the Department of Fish and Game did not list separately the amounts committed for three programs. Moreover, the Web site does not list all of the projects funded by the bond proceeds and does not provide all of the related information required by the executive order, such as a description of the projects and the amounts expended for each. For example, Water Resources provided us a list of 21 projects, totaling about $456 million, that were funded by Proposition 1E, and 11 projects, totaling $79 million, that were funded by Proposition 84 that it has not posted to Finance's Web site. According to Water Resources, it has designed a process to update project information on the bond accountability Web site and anticipates that all projects currently funded by Propositions 1E and 84 will be posted to the Web site at least within one month after funds are awarded, but not less than quarterly.

However, according to Water Resources, posting project information did not happen for the 32 projects just mentioned due to changes in its workload priorities for bond accountability.

Finance stated that it is not practical for it to monitor the Web site on an ongoing basis to ensure that agencies update it as required. However, Finance indicated that it intends to review the administering agencies' compliance with all of the requirements of the executive order, including the requirement to update the Web site, during the audits it is currently planning to conduct each year beginning in fiscal year 2009–10. As part of any future audits we may conduct, we will consider evaluating the quality of information on the Web site and the extent to which agencies are updating the information as Finance expects and the executive order requires.

Review of Bond Accountability Requirements and Processes

We selected six administering agencies, based on the large amount of bond funds allocated to their respective programs, and reviewed the requirements and processes they have designed to provide accountability for their bond program funds. The programs covered by the accountability plans we reviewed make up about 42 percent of the $42.7 billion in bonds the voters approved in the November 2006 general election. For instance, for Proposition 1E, we selected the activities authorized by the Public Resources Code, Section 5096.821. Because this section comprises four program areas, we sampled one, the State-Federal Flood Control System Modification Program, for our detailed review of Water Resources' program policies and guidelines. Finance has approved accountability plans for the seven programs, and all of the agencies have selected projects to fund. Table 7 shows the six administering agencies and the seven programs we selected for review, as well as the amounts of infrastructure bond funds authorized and committed for the programs as of December 12, 2008.

Of the six administering agencies that we reviewed, all have designed management controls that, if followed, are adequate to ensure that bond funds are properly awarded.

We found that the six administering agencies have designed management controls that, if followed, are adequate to ensure that bond funds are properly awarded to projects. The agencies have also developed methods for prioritizing projects for funding and for ensuring that funds are properly expended and projects are periodically monitored. In addition to meeting the requirements imposed by the executive order, many of the programs we reviewed must meet other legal requirements when using bond proceeds. In these cases, the administering agencies have created additional guidelines to ensure that the bond funds are used appropriately.

Table 7
Selected Programs and Funding Commitments as of December 12, 2008, Related to the Infrastructure Bonds Approved in the November 2006 General Election
(in Thousands)

PROPOSITION	ADMINISTERING AGENCY	PROGRAM DESCRIPTION	AMOUNT OF BONDS AUTHORIZED	AMOUNT COMMITTED TO PROGRAM
1B—Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006	California Transportation Commission	Corridor mobility improvement	$4,500,000	$4,489,707
	Department of Transportation	Public transportation modernization, improvement, and service enhancement	3,600,000	530,000
1D—Kindergarten—University Public Education Facilities Bond Act of 2006	State Allocation Board	Kindergarten through 12th grade school facilities program—new construction	1,900,000	982,368
		Kindergarten through 12th grade school facilities program—modernization projects	3,300,000	1,115,676
	University of California	Construction, renovation, or acquisition of university facilities	890,000	841,743
	California State University	Construction, renovation, or acquisition of state university facilities	690,000	607,762
1E—Disaster Preparedness and Flood Prevention Bond Act of 2006	Department of Water Resources	Critical erosion repairs, levee evaluations and repairs, state-federal flood control system modification program	3,000,000	1,158,387

Sources: November 2006 general election propositions and Department of Finance bond accountability Web site.

Because relatively little of the $42.7 billion authorized by voters in 2006 for infrastructure projects has thus far been spent, and parts of the governor's bond accountability plan have not been fully implemented, we are keeping this issue on our high-risk list.

Human Resources Management

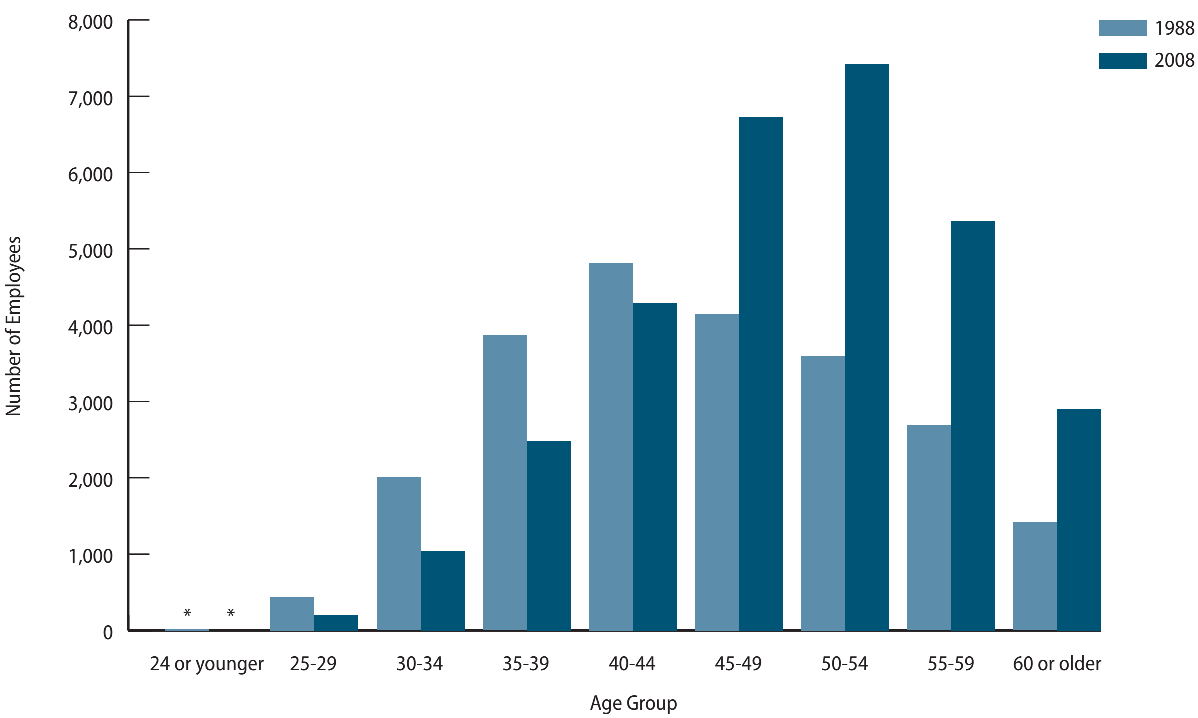
The Bureau issued a report in March 2009[7] which concluded that the State is currently facing, and will continue to face, the retirement of a significant number of today's workers in both leadership and rank-and-file positions. Although these employees are near or at retirement age, it is unknown whether the developments in the worldwide and national financial markets and the State's actions to solve its budgetary problems will affect state employees' retirement plans. Regardless of the precise timing of these retirements, the fact remains that these employees will eventually retire and planning for these retirements is prudent to ensure continued delivery of state services.

[7] *High-Risk Update—Human Resources Management: A Significant Number of State Employees Are Beginning to Retire, While Certain Departments That Provide Critical State Services Lack Workforce and Succession Plans* (March 2009, Report 2008-605).

State Workforce Retirements

During the 20-year period between 1988 and 2008, the number of full-time permanent state employees has increased from roughly 136,700 to just over 200,000. During this same period, the age demographics of these workers have changed. The proportion of workers in older age groups has grown significantly compared to 20 years ago. Based on data provided by the State Personnel Board (Personnel Board), figures 3 and 4 compare the age distribution of state workers between June 30, 1988, and June 30, 2008. Figure 3 focuses on employees in leadership[8] positions and Figure 4 targets those in rank-and-file positions.

Figure 3
Comparison of Ages of State Employees in Leadership Positions as of June 30, 1988, and June 30, 2008



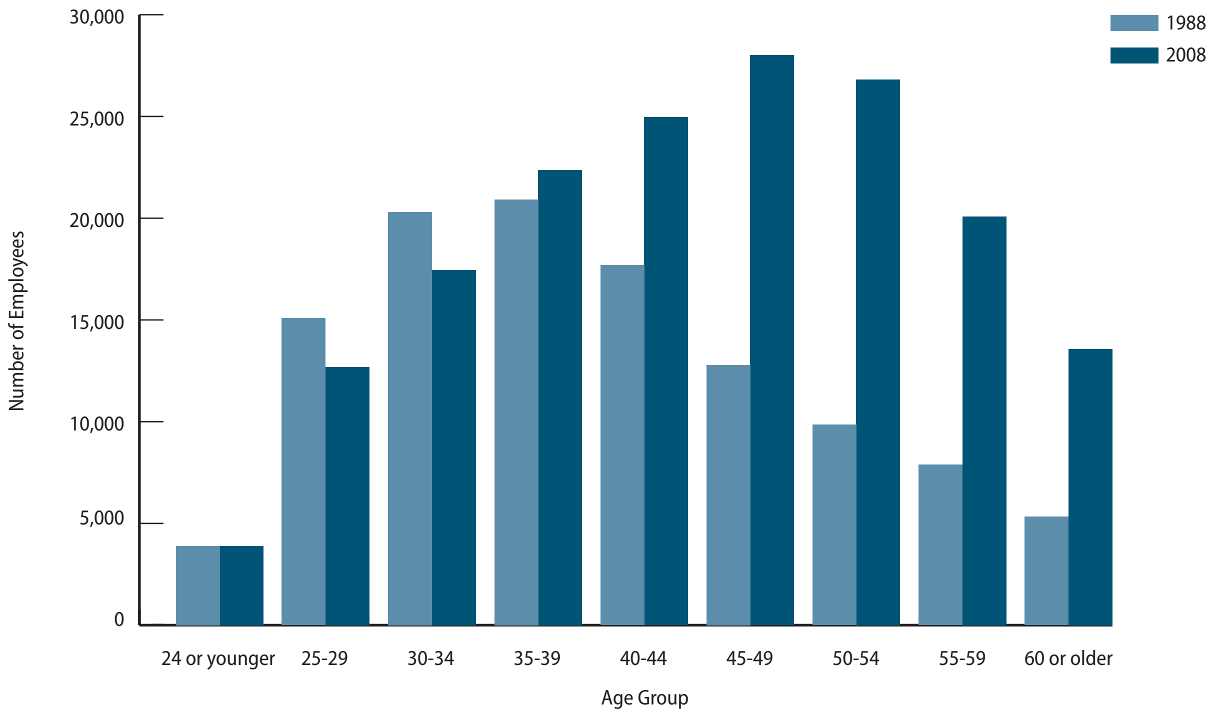
Source: Bureau of State Audits' analysis of data provided by the State Personnel Board (Personnel Board).

Note: The data presented above only include civil servants who are full-time and permanent employees, or are serving in career executive assignment (CEA) positions. Further, the data are limited to those in leadership positions—those working in managerial, supervisory, or CEA positions. Finally, according to the Personnel Board, the data shown exclude certain state employees, such as those working for the judicial branch, the legislative branch, and the California State University.

* As of June 30, 1988, there were 22 employees working in leadership positions who were 24 years old or younger. By June 30, 2008, this number had fallen to six employees.

[8] We define employees in leadership positions as those individuals the Personnel Board classifies as working in supervisory, managerial, or career executive assignment positions.

Figure 4
Comparison of Ages of State Employees in Rank-and-File Positions as of June 30, 1988, and June 30, 2008



Source: Bureau of State Audits' analysis of data provided by the State Personnel Board (Personnel Board).

Note: The data presented above only include civil servants who are full-time and permanent employees. Further, the data excludes those employees working in managerial, supervisory, or career executive assignment positions. Finally, according to the Personnel Board, the data shown exclude certain state employees, such as those working for the judicial branch, the legislative branch, and the California State University.

As the figures demonstrate, the age distributions for both leadership and rank-and-file employees have shifted to the right, reflecting the State's now older workforce. For example, data in Figure 3 shows that most employees in 1988 who were in leadership positions were between the ages of 40 and 44. However, by 2008, most state workers in leadership positions were between the ages of 50 and 54. Looking at the same data used to create Figure 3 in a slightly different way, it is apparent that the percentage of employees who are at least 50 years of age has dramatically increased. In 1988 about 33 percent of all employees in leadership positions were at least 50 years of age. Figure 4 demonstrates that the State has seen similar trends for its rank-and-file employees.

Although the makeup of the State's workforce is proportionally older now than it was 20 years ago, the average age at retirement for these workers has been relatively stable over roughly the same time period. The average age at retirement for employees in leadership and rank-and-file positions has been around 60 years of age. Further, the average and median retirement ages have remained

Rate of Retirement by Age Group—State Civil Service Employees in Leadership Positions

AGE GROUP	PERCENT OF GROUP WHO RETIRE EACH FISCAL YEAR
Less than 50	Less than 1.00%
50 to 54	3.76
55 to 59	12.07
60 or older	30.57

Source: Bureau of State Audits' analysis of data provided by the State Controller's Office.

generally consistent based on our review of five selected years between fiscal years 1990–91 and 2007–08. Even though, on average, state workers retire as they approach 60 years of age, not all employees retire at this age. Using data from the Personnel Board covering five selected years between fiscal years 1990–91 and 2007–08, we determined, on average, the percentage of retirees in a given year who retire at specific ages. While the median retirement age for leadership and rank-and-file employees is around the age of 60, distinctive peaks show up at the ages of 55 and 62.

Using the number of retirees previously described in a different way, we determined what proportion of all state employees—within certain age groupings—usually retire in a given fiscal year. As shown in the text box, more than 30 percent of all workers in leadership positions who are at least 60 years of age retire each fiscal year. Similarly, 12 percent of these workers who are between the ages of 55 and 59 retire. Finally, nearly 4 percent of those in leadership positions and between the ages of 50 and 54 retire each fiscal year.

Using these retirement rates by age group, we calculated the projected total fiscal year 2008–09 retirement rates for employees in leadership positions. We followed a similar exercise for employees in rank-and-file positions. As shown in Figure 5, by fiscal year 2014–15, nearly 13,000—or about 42 percent—of fiscal year 2008–09 employees in leadership positions could potentially retire, and therefore need to be replaced, in the next seven fiscal years.

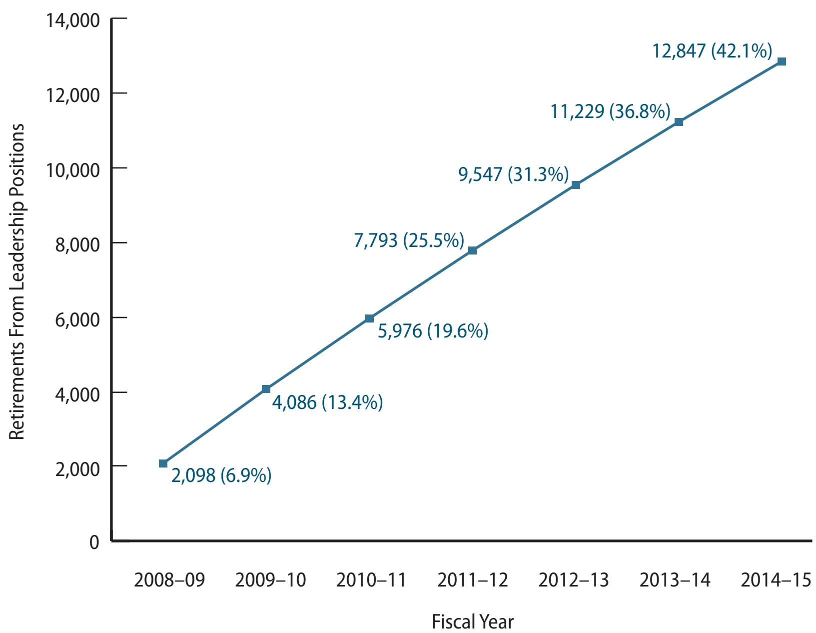
Even though projections are estimates and actual retirements may differ from the projections shown in the figure, the fact remains that a substantial number of state employees are approaching retirement. Regardless of whether these employees retire within two years or 10 years, it is imperative for the State to have a plan to deal with these retirements given the fact that they likely have unique perspectives and institutional knowledge critical to running various state departments and programs.

Workforce and Succession Planning

In May 2007 the Bureau issued its first high-risk report in which it described that the State will soon face the consequences resulting from the retirement of a significant portion of its current workforce, including many of its top managers and key staff. The Bureau noted that beyond its model on workforce planning, Personnel

Administration had provided little direction to state departments in terms of succession planning. The Bureau concluded that Personnel Administration's efforts fell short of what is needed to attract, train, and retain tomorrow's government leaders.

Figure 5
Cumulative Number of Potential Retirements From Leadership Positions Fiscal Years 2008–09 Through 2014–15



Source: Bureau of State Audits' analysis of data provided by the State Personnel Board and the State Controller's Office.

Note: The projections shown in this figure are based on forecasts of when employees currently in leadership positions—those working in managerial, supervisory, or career executive assignment positions—might retire from state service. Our forecasts began with employees in state service as of June 30, 2008. For each projected year, we *retired* a certain percentage of these employees based on the historical retirement rates of those between the ages of 50 through 54, 55 through 59, and 60 or older.

Since the issuance of the report, Personnel Administration has focused much of its efforts on workforce planning—it considers succession planning a subset of workforce planning—and on modernizing and streamlining the State's human resource system to recruit, develop, and maintain a well-qualified, high-performance workforce. For example, in April 2008 Personnel Administration hired a statewide workforce planning manager who has worked diligently to help educate departments about the urgency of workforce planning and the steps necessary to develop workforce plans. Although its statewide workforce planning manager acknowledges that the State is relatively late in developing centralized workforce planning, Personnel Administration's director has spoken about the need to elevate such planning as a management priority on a statewide level, and since April the statewide workforce planning manager has worked effectively to organize conferences and workshops, and to provide information to departments on how to conduct workforce and succession planning. For example, it hosted two workforce planning conferences in conjunction with the Personnel Board—the first conference was held in April 2008 and the second in November 2008—which drew many participants from various state departments.

Although not yet finalized, Personnel Administration also plans to institute a statewide workforce planning requirement in 2010 and, as part of this requirement, it plans to request copies of each department's workforce and strategic plans. The goal, according to the statewide workforce planning manager, is to use data from the department workforce plans to develop a statewide plan. Personnel Administration has not yet decided how frequently—annually or biennially—it will request department reports or produce a statewide plan. The statewide workforce planning manager explained that by offering departments support now, Personnel Administration is helping to prepare them for a potential workforce planning requirement in the future.

In an attempt to address the State's lengthy hiring and other statewide human resources issues, Personnel Administration and the Personnel Board are working on the Human Resource Modernization Project (HR-Mod). HR-Mod is an ambitious, far-reaching project with workforce planning, compensation, classification, recruitment/selection, and performance management components. One of HR-Mod's goals is to streamline the State's hiring process. For example, it has made certain exams for state employment continuously available online, such as those for attorneys. Similarly, those working on HR-Mod plan to add online exams for various other types of workers, including managers, sometime in 2009. Using such online testing strategies would seem to offer greater opportunities to speed up the hiring process since potential candidates would not have to wait to get tested at a state testing center. According to the director of Personnel Administration, HR-Mod has made changes to the recruitment, selection, and hiring process, such as revising the entrance requirements and increasing the starting salary for staff services analysts, and conducting an open staff services manager exam. He stated that by putting these modernization efforts in place now and over the next several years, HR-Mod will have a huge impact on the ability of departments to deal with the wave of projected retirements. However, according to HR-Mod's deputy project director for systems automation, some of HR-Mod's project initiatives will take a significant amount of time to complete due in part to statutory and administrative

Using online testing strategies would seem to offer greater opportunities to speed up the hiring process since potential candidates would not have to wait to get tested at a state testing center.

requirements. HR-Mod formally began work in fiscal year 2007–08 and will end with the final rollout tentatively planned for fiscal year 2014–15. Given this time frame, it is uncertain whether HR-Mod's efforts to streamline the hiring process will come in time to benefit state departments as they try to replace retiring employees now and over the next few years.

Workforce and Succession Plan Development

Even though California recently began its centralized workforce planning efforts, other states began their efforts several years ago, and some, as well as the federal government, have instituted certain planning requirements. For example, we reviewed three states—Virginia, Texas, and South Carolina—that received a rating of "strength" from the Pew Center on the States (Pew Center) in strategic workforce planning in 2008. According to state personnel and a review of state laws, each state began its planning efforts at least seven years ago. In contrast, the Pew Center gave California a "mid-level" rating, noting the State's lack of an overarching assessment of agency efforts and the fact that it is unclear how many departments actually do workforce planning. Virginia, Texas, and South Carolina's early start has given those states the time to educate their departments and to develop robust workforce planning resources. Virginia and Texas also require departments to periodically develop strategic plans, which are a key resource for workforce and succession planning. The Government Accountability Office states that an organization's human capital strategies need to be aligned with its strategic plan, which considers not only current but also its emerging mission and goals. Similarly, the *2008 State of California Workforce Planning Model and Guide*, developed by Personnel Administration, stipulates that workforce planning depends upon, compliments, and logically follows strategic planning.

Seven Steps Identified in the Department of Personnel Administration's State of California Workforce Planning Model

Step 1: Review strategic plan. Review your department's strategic plan mission, vision, and measurable goals and objectives, and time frames for accomplishing them.

Step 2: Identify work functions. Identify the work functions that must be performed in order to accomplish the strategic plan.

Step 3: Identify staffing requirements. Identify the staffing, both in number of staff and competencies, required to accomplish the work functions.

Step 4: Project workforce supply. Project your workforce, including numbers of staff as well as competencies, taking into account attrition, and assuming no management actions taken to replace staff lost through attrition.

Step 5: Analyze workforce gaps. Compare the staffing requirements in Step 3 with the projected workforce supply in Step 4 and determine the gap.

Step 6: Develop priorities and implement solutions. Analyze your workforce needs (the gap), establish priorities, and implement solutions for meeting those needs.

Step 7: Evaluate the plan. Assess what is working and what is not. Make adjustments as needed. Address new workforce and organizational issues.

Source: Department of Personnel Administration.

On the federal level, the Government Performance and Results Act of 1993 requires each executive agency to submit to the Office of Management and Budget, and to Congress, a strategic plan that covers a period of not less than five years and is required to be updated and revised at least every three years. Yet, California does not impose a statewide requirement for departments to engage in either strategic, workforce, or succession planning. Nevertheless, Personnel Administration's workforce planning model specifies that workforce planning begins with reviewing a strategic plan, followed by determining the staffing needs to follow through on the plan. Although departments are not required to follow this model, the seven steps outlined in the text box on the previous page present a thoughtful approach to developing workforce and succession plans. Thus, given that California does not impose a statewide requirement for departments to engage in strategic planning, it may put departments at a disadvantage to fully develop workforce and succession plans because they have not determined the types of services and workforce needs they will have in the future.

Departments' Retirement Rates

While the projected retirement rates presented previously define the problem of the loss of knowledge and expertise on a statewide level, the condition is worse for some important departments that provide critical services to the public. As shown in Table 8, the proportion of employees age 50 or older in leadership positions at each of the five departments we reviewed, which have a role in the public's health and safety, range from a low of 55 percent at Transportation to a high of 66 percent at the Department of Social Services (Social Services)—exceeding the statewide average of 52 percent.

Table 8
Age of State Employees in Leadership Positions for Selected Departments as of June 30, 2008

DEPARTMENT	NUMBER OF EMPLOYEES IN LEADERSHIP POSITIONS	EMPLOYEES IN LEADERSHIP POSITIONS AGE 50 OR OLDER							
		50 THROUGH 54		55 THROUGH 59		60 OR OLDER		TOTALS	
		NUMBER	PERCENT	NUMBER	PERCENT	NUMBER	PERCENT	NUMBER	PERCENT
California Department of Public Health	597	137	23%	144	24%	108	18%	389	65%
Department of Health Care Services	495	112	23	117	24	73	15	302	61
Department of Transportation	3,494	944	27	649	19	331	9	1,924	55
Office of Emergency Services	81	26	32	14	17	10	12	50	62
Department of Social Services	587	155	26	158	27	77	13	390	66
All state employees in leadership positions	30,442	7,425	24	5,363	18	2,898	10	15,686	52

Source: Bureau of State Audits' analysis of data provided by the State Personnel Board (Personnel Board).

Note: The data presented above only includes civil servants who are full-time and permanent employees, or are serving in career executive assignment (CEA) positions. Further, the data is limited to those in leadership positions—those working in managerial, supervisory, or CEA positions. Finally, according to the Personnel Board, the data shown exclude certain employees, such as those working for the judicial branch, the legislative branch, and the California State University.

Similarly, as shown in Table 9, the five departments have a high proportion of employees age 50 or older in rank-and-file positions, ranging from 41 percent at Transportation to 51 percent at the

Department of Public Health (Public Health)—substantially surpassing the statewide average of 36 percent. Even with the unknown effects of the worsening worldwide and state economies, the data presented in tables 8 and 9 are sobering and further underscore the need for departments to evaluate the age of their workforce and undertake efforts to mitigate this potential loss of knowledge and expertise.

Table 9
Age of State Employees in Rank-and-File Positions for Selected Departments as of June 30, 2008

DEPARTMENT	NUMBER OF EMPLOYEES IN RANK-AND-FILE POSITIONS	EMPLOYEES IN RANK-AND-FILE POSITIONS AGE 50 OR OLDER							
		50 THROUGH 54		55 THROUGH 59		60 OR OLDER		TOTALS	
		NUMBER	PERCENT	NUMBER	PERCENT	NUMBER	PERCENT	NUMBER	PERCENT
California Department of Public Health	2,475	494	20%	457	18%	308	12%	1,259	51%
Department of Health Care Services	2,295	443	19	347	15	244	11	1,034	45
Department of Transportation	17,342	3,261	19	2,315	13	1,620	9	7,196	41
Office of Emergency Services	395	78	20	61	15	35	9	174	44
Department of Social Services	2,984	517	17	445	15	323	11	1,285	43
All state employees in rank-and-file positions	169,572	26,817	16	20,082	12	13,577	8	60,476	36

Source: Bureau of State Audits' analysis of data provided by the State Personnel Board (Personnel Board).

Note: The data presented above only includes civil servants who are full-time and permanent employees, or are serving in career executive assignment (CEA) positions. Further, the data excludes those in leadership positions—those working in managerial, supervisory, or CEA positions. Finally, according to the Personnel Board, the data shown exclude certain state employees, such as those working for the judicial branch, the legislative branch, and the California State University.

Further, the five departments will have to replace larger proportions of their employees in leadership positions than those retiring from rank-and-file positions. For instance, Public Health would likely experience the loss of significant institutional knowledge and expertise if more than 10 percent of its employees in leadership positions actually decide to retire as projected during fiscal year 2008–09. However, of greater concern is that more than half, or 54 percent, of its leadership workforce will potentially retire within the next seven fiscal years, or by fiscal year 2014–15. In fact, it is likely that the Department of Health Care Services (Health Care Services) and Social Services will also need to plan on how to replace over half of their leadership staff during this same time period. By comparison, as discussed previously, the average proportion of employees in leadership positions statewide who will likely retire in fiscal year 2008–09 is about 7 percent; however, Public Health, Health Care Services, and Social Services can expect to lose between 9 percent and 10 percent of their leadership that same year. To the extent that they have not already undertaken succession and workforce planning efforts, particularly for those positions that impact the public's health and safety directly, the departments could inadvertently place the public, as well as the State, at risk of not delivering services in accordance with their respective statutory purposes.

Replacing Retiring Employees

Most of the departments we reviewed agree that they will have difficulty replacing retiring employees in both rank-and-file and in leadership positions. They cited various factors that contribute to these difficulties, including the State's lengthy hiring process and its lower salaries. For example, the manager of Social Services' office of professional management development and succession planning (planning office) explained that the State's hiring processes are challenging, lengthy, and not geared to younger workers who are Internet savvy and want instant results. The chief of Transportation's staff development and workforce planning division echoed these sentiments when she cited the length of the State's hiring process as one of the obstacles to finding replacements for retirees.

One manager commented that the State's hiring processes are challenging, lengthy, and not geared to younger workers who are Internet savvy and want instant results.

Three of the five departments we reviewed also explained that their ability to replace retirees with new employees is affected by how well they can compete with the private sector and its ability to offer higher salaries. For example, the chief of human resources for Public Health stated that many of her department's job openings require extensive experience and that Public Health uses the same candidate pool as the private sector where pay and benefits packages are higher. Further, its chief of human resources explained that even when Public Health is able to hire someone, employee retention is a problem. Many scientists begin their careers in a public laboratory but then leave once they are trained—working for private-sector firms such as Kaiser Permanente or a biotech laboratory. One department we reviewed also voiced concern over its ability to replace retiring managers due to salary compaction with rank-and-file employees. The personnel and labor relations officer with the Office of Emergency Services (Emergency Services) explained that staff in rank-and-file positions frequently receive overtime pay and, as a result, can earn more than managers and supervisors who are not eligible to receive overtime. Further, according to the personnel and labor relations officer, some rank-and-file staff, those in positions that affect the public's safety, enjoy a better retirement plan than their managers and supervisors. The personnel and labor relations officer stated that as a result, it is sometimes difficult to entice rank-and-file staff into management roles.

Steps to Address Potential Worker Shortages

Although California does not impose a statewide requirement for departments to engage in either strategic or workforce and succession planning, and are similarly not required to follow Personnel Administration's model, we believe that developing workforce and strategic plans in light of the impending number of retirements is a necessary and prudent business practice. Most of the departments we reviewed generally have current strategic plans, but none have written workforce and succession plans that address all of the steps in Personnel Administration's workforce planning model. Despite this, the departments we reviewed have undertaken some planning efforts to address their aging workforces.

For example, according to Social Services' manager of its planning office, the department has undertaken an overall workforce management initiative that includes a succession planning component. She explained that although Social Services does not have workforce and succession plans in a formal report format, it does have a long-term strategy. Further, Social Services has identified workforce development, which includes proactively addressing its higher rates of impending retirements, as one of its top six department-wide best practices. The manager of its planning office stated that Social Services launched its workforce and succession planning efforts in 1997, beginning with a professional management development program that not only supports improved leadership performance but aids Social Services' succession needs by helping to prepare future leaders.

__Although one of the five departments we reviewed has undertaken an overall workforce management initiative that includes a succession planning component, the remaining four are in the early stages of workforce and succession planning.__

In contrast, the remaining four departments are in the early stages of workforce and succession planning. For example, Public Health's chief of human resources acknowledges that her department began their efforts in October 2008 by hiring a consultant to help develop a new Office of Leadership and Workforce Development that would be responsible for the department's planning efforts. Similarly, Health Care Services established its own Workforce Planning and Development Office in July 2008. Additionally, Transportation does not have workforce or succession plans; however, it has created a specific unit within the department— the Division of Staff Development and Workforce Planning (development and planning division)—that will focus on developing these plans in the future. The current chief of the development and planning division assumed her role in October 2008; however, Transportation does not have an estimate for when it will complete its department-wide workforce plan. Finally, Emergency Services does not have a workforce and succession plan and intends to use a consultant to help develop these documents. The deputy director indicated that Emergency Services plans to hire the consultant to begin work in February or March 2009 on a comprehensive workforce plan.

Low-Cost Planning Strategies

Although some strategies for recruiting, retaining, and developing staff may be fiscally out of reach given the State's current economic climate, some departments have implemented low-cost strategies.

Some strategies for recruiting, retaining, and developing staff— such as adjusting pay to make it comparable to other sectors or instituting formal training programs—may be fiscally out of reach in the State's current economic climate. Yet, some departments have implemented low-cost solutions that could be useful for others to consider as they implement their workforce and succession planning efforts. For instance, as a retention strategy, Social Services has organized quarterly group discussions between staff-level division representatives and their chief deputy director. Prior to the meeting, staff are encouraged to submit questions to the staff-level representatives, anonymously or signed. During the meeting, the chief deputy director discusses and responds to the questions. Following the meeting, Social Services distributes the questions and answers via e-mail and makes them available on its internal communication system. According to the manager of Social Services' planning office, staff have expressed their strong appreciation of the program and value the positive changes they have seen within their own divisions, including improved communication, a higher degree of trust in their managers, increased concern from the supervisors, actual revisions to policies, and other tangible and intangible improvements.

Numerous other low-cost strategies for developing employees also exist. To begin with, creating an individual development plan for each employee provides direction for future development opportunities. According to CPS Human Resource Services, a consulting firm that studied various succession planning activities, low-cost options that may develop employees include mentoring programs, job shadowing, site visits to observe and learn about different job assignments, and rotational assignments. For instance, according to the chief of Transportation's staff development and workforce planning division, the department has a long-established rotation program for entry-level engineers, which not only develops staff but is also a key recruitment tool. Low-cost strategies for ensuring that department knowledge is captured also might include routinely taking minutes or recording meetings, updating procedures manuals, and videotaping an expert as she or he demonstrates how to complete a critical task. Following such strategies deserves consideration from departments, particularly in light of today's fiscal constraints.

Other Postemployment Benefits of Retiring State Employees

The escalating number of retiring employees will significantly increase the State's cost of providing them other postemployment benefits. Consequently, the Bureau's May 2007 report identified *other postemployment benefits*—or benefits in addition to pensions—as a statewide high-risk issue. Commonly referred to as OPEB, other postemployment benefits encompass medical and dental insurance primarily. Additionally, our 2007 report indicated that on an actuarial basis as of June 30, 2007, California's total OPEB liability was estimated to be $48 billion. In our April 2009 report,[9] the Bureau assessed the State's progress in managing this liability.

Both reports highlighted that the State faces risk in at least two areas: Providing the level of benefits promised to its employees and at the same time protecting its credit rating. Reporting OPEB information in accordance with the Governmental Accounting Standards Board's (GASB) requirements will, among other things, provide readers of financial statements with information useful in assessing potential demands on the State's future cash flows.[10] Bond-rating agencies have already made it clear that they will look with disfavor on governments that do not sufficiently plan for managing such liabilities. To protect its credit rating and ensure that it can borrow at the lowest available interest rates, the State will need to demonstrate that it is adequately managing the long-term costs of its OPEB.

Overview of the State's OPEB

New accounting rules issued by GASB spotlighted the cost of medical and dental benefits for retired state employees. In exchange for their services, state employees receive compensation in various forms. In addition to the salaries and benefits that employees receive, they also earn benefits that they will not receive until after their employment with the State ends. The most recognized type of these postemployment benefits is a pension. In addition, the State, like many other government employers, provides retired employees with OPEB, or health (medical and prescription drug) and dental benefits.[11] The State generally pays 100 percent of the health insurance costs for retirees and 90 percent of the additional insurance premiums for retirees' family members. In addition, the State generally pays all or a portion of retirees' dental insurance costs, depending on the retirees' years of state service at retirement. As of June 30, 2008, approximately 138,300 retirees were receiving health benefits, and 112,600 retirees were receiving dental benefits.

As of June 30, 2008, approximately 138,300 retirees were receiving health benefits, and 112,600 retirees were receiving dental benefits.

9 *High-Risk Update—Other Postemployment Benefits: Significant Financial Risk Exists if the State Does Not Actively Manage the Costs of State Retirees' Health and Dental Benefits* (April 2009, Report 2008-607).

10 GASB is the entity that establishes accounting standards that governments must follow when providing audited financial statements.

11 The State also offers life insurance, long-term care, and vision benefits to retirees; however, because these benefits are completely paid for by retirees, there is no OPEB liability to the State.

For financial reporting purposes, the University of California and 58 county superior courts (trial courts) are considered separate employers. As separate employers, these entities determine their own benefits, benefit levels, and funding policies, and because these entities have separate actuarial surveys to determine their OPEB costs, we have generally excluded them from our analysis. In addition, most California cities, counties, and other local governmental entities have OPEB liabilities. However, the State is not directly responsible for these entities' OPEB liabilities, so we omitted them from most of our analyses.

Accounting for OPEB Costs

Historically, state and local governments have treated the future costs of retirees' health and other nonpension benefits differently from the future costs of pensions. Most governments usually prefund the future costs of pensions—that is, most state and local governments have established dedicated trust funds in which they deposit money to finance the anticipated costs of pensions for current and past employees. The State contributes to these pension trust funds to fully or partially cover the amount needed to pay for current and past employees' *pension costs.*[12] Various actuaries prepare periodic reports indicating the amount of money the State needs to deposit into pension trust funds each year to meet both current and future pension costs.

In contrast to setting aside funds for future costs of pensions as most state and local governments do, the State appropriates only enough money in its annual budget to pay the yearly premiums for retiree health insurance.

In contrast, the State and many other governments have not chosen historically to prefund OPEB costs through deposits to a trust fund. Rather, the State appropriates only enough money in its annual budget to pay the yearly premiums for retiree health (medical and dental) insurance. Known as *pay as you go*, this method of funding OPEB costs addresses only the current year's costs and does not set aside funds to cover any future costs to the State. One of the main reasons for the difference in the treatment of pension costs and OPEB costs is that GASB has not previously required state and local governments to calculate and report the future cost of the retiree benefits beyond pensions that the governments promised to current and past employees.

Required Estimates and Disclosure of OPEB Costs

Titled *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, GASB Statement No. 45 (GASB 45), required the State to begin recognizing in its

[12] Most current state employees participating in the California Public Employees' Retirement System also make contributions toward their pension benefits during each pay period.

financial statements for fiscal year 2007–08 the current and future cost of state retirees' health benefits. For previous fiscal years, GASB had required governments to provide basic information about their OPEB plans and the amount of benefits paid in a particular fiscal year. The GASB's new reporting requirements for OPEB costs are now similar to those for pensions. Specifically, it requires that state and local governments move from a cash basis method of accounting for OPEB costs to one that recognizes both the current and future cost of these benefits. In other words, instead of simply showing the amount that the State is paying for current retirees' medical insurance each year, the State must now estimate and show the total amount that it will owe to all of its employees—both current and past—when they retire. The State must also report the extent to which it is funding this amount. This new requirement applies only to the way in which OPEB costs are accounted for—that is, how each government's financial statements show the costs. The new requirement does not mandate that the government pay for these costs, nor does it require governments to set aside money to fund these future payments. However, the requirement to disclose the full extent of these costs has highlighted the existence of a large liability facing the State that will continue to grow unless the State begins to prefund OPEB costs.

Because the State needs to calculate its total OPEB amount owed and the amount that it would need to pay each year to fully fund this liability—the annual required contribution—GASB now requires the State to have an actuarial study performed at least every two years.

As of June 30, 2008, the State's total estimated OPEB liability was $48.22 billion. The State must set aside funds or record a liability for a portion of it each year.

According to its second and most recent actuarial study, as of June 30, 2008, the State's total estimated OPEB liability was $48.22 billion. In today's dollars this figure represents the future cost of retiree health benefits that state employees have already earned. Because the State has not established a trust or set aside any money to pay for these benefits, this entire liability is currently unfunded. GASB does not require that the State show this entire unfunded amount as a liability in its financial statements. Instead, the State is allowed to recognize a portion of this liability each year, over a period of up to 30 years. The State includes this annual portion, along with amounts to cover the costs of benefits earned during the current year, in the calculation of its annual required contribution. Essentially, the annual required contribution is the amount that the State would need to contribute each year to fully fund the estimated benefits that state employees have earned but that the State will not pay until sometime in the future. According to GASB, as long as an employer sets aside funds each year that are sufficient to cover the annual required contribution, the employer does not need to record a liability in its financial statements.

However, in fiscal year 2007–08, the State paid only $1.25 billion toward the annual required contribution of $3.59 billion. Therefore, it reported in its financial statements a $2.34 billion liability for future OPEB costs as of June 30, 2008. This underfunding occurred because the State was using the pay-as-you-go funding approach and paying only for current retirees' medical and dental insurance premiums as they occurred.

For fiscal year 2008–09, the State's annual required contribution is $3.72 billion, of which the State expects to pay $1.36 billion for the current cost of retirees' medical and dental insurance premiums under the pay-as-you-go funding method. Table 10 lists the components of the calculation of the projected OPEB liability for fiscal year 2008–09, which is a projection based on the actuarial report since at the time our report on OPEB was issued, fiscal year 2008–09 had not yet ended. Because the State did not pay enough of its annual required contribution in fiscal year 2007–08, it must include interest on the $2.34 billion liability from that year, as well as an actuarial adjustment, in its calculation of the annual OPEB expense for fiscal year 2008–09. Based on this calculation, the full OPEB expense for fiscal year 2008–09 will be $3.73 billion. However, because the State expects to pay only $1.36 billion, it projects that its liability in the current year will increase by $2.37 billion. The State must add this increase to the $2.34 billion liability recognized in fiscal year 2007–08, for a total recognized OPEB liability of $4.71 billion that the State will need to disclose in its financial statements for the fiscal year ending June 30, 2009.

Table 10
Projected Calculation of the State's Liability for Other Postemployment Benefits
Fiscal Year 2008–09
(In Thousands)

	AMOUNT
Annual required contribution	$3,715,201
Interest and actuarial adjustments*	12,810
Annual Other Postemployment Benefits (OPEB) Expense	**$3,728,011**
Expected employer cash payments	(1,360,672)
Increase in Projected Liability	**$2,367,339**
Recognized OPEB Liability—July 1, 2008	**$2,340,886**
Projected OPEB Liability—June 30, 2009	**$4,708,225**

Source: *State of California Retiree Health Benefits Program: GASB Nos. 43 and 45 Actuarial Valuation Report As of June 30, 2008* (dated September 15, 2008).

Notes: This table does not include the University of California or the trial courts.

Because at the time our report on OPEB was issued, fiscal year 2008–09 had not yet ended and because the State's actual contributions for this fiscal year were still unknown, this calculation is a projection based on the actuarial report.

* This amount is the net of interest on the July 1, 2008, OPEB liability and an actuarial adjustment resulting from the fiscal year 2007–08 contribution deficiency.

Financial Risks of Not Managing OPEB Liabilities

OPEB will continue to be a high-risk issue for many governments as long as they continue to use the pay-as-you-go method of funding OPEB costs without setting aside additional funds or taking other actions to address OPEB liabilities. In future years, the OPEB liability reported by the State, if the State has not substantially funded those costs, could grow so rapidly that it could begin to overshadow other liabilities on its financial statements and affect the State's credit rating. In fact, in its April 2009 official statement for general obligation bonds, the State acknowledged, "The long-term costs for other post-employment benefits may negatively affect the State's financial reports and impact its credit rating if the State does not adequately manage such costs." A weaker credit rating could compound the State's budget problems by increasing the costs of borrowing money when it issues bonds. If the State continues to use its pay-as-you-go funding method, the State's second actuarial study concludes that "the annual OPEB costs could range from three to five times the pay-as-you-go costs and the balance sheet liability could grow exponentially."

__A 2007 survey revealed that a majority of responding public agencies within California are using the pay-as-you-go method of funding other postemployment benefits rather than setting aside funds for future costs.__

A majority of other public agencies within California face the same risks that exist at the state level according to data compiled by the governor's Public Employee Post-Employment Benefits Commission (Commission). In December 2006 the governor created the Commission to report on how the State and California's local governments were addressing their OPEB liabilities. Released in January 2008, the Commission's report included the results of a survey that took place in May and June 2007 at public agencies throughout California in part to identify the agencies' practices for addressing OPEB liabilities. As Table 11 on the following page shows, approximately 78 percent of the survey respondents reported that they are using the pay-as-you-go method of funding OPEB, while only 22 percent partially or fully prefund their OPEB obligations.

In addition, as Table 11 indicates, these public agencies reported a combined unfunded OPEB liability of more than $71 billion according to their most recent actuarial valuations at the time of the survey. Moreover, the Commission's report acknowledged that the combined OPEB liability is probably understated because only 37 percent of the agencies that reported offering OPEB also included data on their OPEB liability.

Table 11
The Funding Policies and Total Unfunded Liability for the Other Postemployment Benefits of Public Entities in California

	CALIFORNIA GOVERNMENTAL ENTITIES			FUNDING POLICIES		TOTAL UNFUNDED LIABILITY FOR OTHER POSTEMPLOYMENT BENEFITS (IN BILLIONS)
	TOTAL CONTACTED FOR SURVEY	TOTAL RESPONDED TO SURVEY	PERCENTAGE RESPONDING	PERCENTAGE USING PAY-AS-YOU-GO METHOD	PERCENTAGE USING PARTIAL OR FULL FUNDING	
Counties	58	58	100%	77%	23%	$28.0
School districts	1,036	475	46	79	21	15.9
University of California	1	1	100	100	0	11.5
Cities	478	231	48	80	20	8.8
Special districts	2,052	374	18	78	22	3.5
Community colleges	72	39	54	51	49	2.5
Trial courts*	–	–	–	–	–	1.3
Totals	**3,697**	**1,178**	**32%**	**78%**	**22%**	**$71.5†**

Source: *Funding Pensions & Retiree Health Care for Public Employees: A Report of the Public Employee Post-Employment Benefits Commission* (Commission).

* We obtained trial court data from separate actuarial surveys dated July 1, 2007, because the Commission's survey did not include trial courts. As a result, we include only the total unfunded liability for trial courts. However, those trial courts that offer other postemployment benefits (OPEB) use the pay-as-you-go method.

† As noted on page 51, because many agencies were still in the process of complying with Governmental Accounting Standards Board requirements at the time of the Commission's survey, only 37 percent of the agencies that reported offering OPEB also included data on their OPEB liability. Consequently, this amount is understated.

Like California, most other states use the pay-as-you-go method to fund OPEB and thus underfund their OPEB liability. According to a report released in December 2007 by the Pew Center, only six states (Arizona, North Dakota, Ohio, Oregon, Utah, and Wisconsin) had a policy of fully funding their annual required contribution, and only three states (Alaska, Arizona, and Wisconsin) had funded more than 50 percent of their total estimated OPEB liability. Since the report's publication, some states have begun to move toward partial or full funding of OPEB. However, states like California that continue to allow their OPEB liability to grow unchecked may see negative effects on their credit ratings.

Potential Savings for Prefunding OPEB

The State has three basic options for funding its estimated OPEB liability: the current pay-as-you-go method, partial-funding method, or full-funding method. Table 12 shows the advantages and disadvantages of each funding method. The pay-as-you-go approach, which the State currently uses, means that it pays only for medical and dental insurance for employees already retired when the insurance premiums are due. The pay-as-you-go method requires the smallest annual employer cash payment of the three funding methods—a situation that benefits the State's short-term cash-flow situation. However, the approach also results in the largest annual OPEB expense and the fastest-growing OPEB liability recognized in the State's financial statements because the State is not setting aside any funds to pay for retirees' future health benefits. The partial-funding method entails setting aside some cash reserves each year to pay for future OPEB costs in addition to paying for the medical and dental premiums of employees already retired. Under this funding approach, the annual cash payment that an employer makes is less than the required contribution, and this circumstance means that the OPEB liability reported in the employer's financial statements will continue to grow; however, the liability will grow at a slower rate than under the pay-as-you-go method. As Table 12 shows, the full-funding method requires the largest cash payment by the employer, and it means that the employer is making the full amount of the annual required contribution every year and therefore does not need to recognize an OPEB liability in its financial statements as long as the employer has always fully funded OPEB. Moreover, the full-funding method results in the lowest annual OPEB expense, as compared to the pay-as-you-go or partial-funding approaches.

Table 12
Advantages and Disadvantages of Different Methods of Funding Other Postemployment Benefits

APPROACH	EMPLOYER CONTRIBUTIONS	ANNUAL OTHER POSTEMPLOYMENT BENEFITS (OPEB) EXPENSE	RECOGNIZED OPEB (FINANCIAL STATEMENT) LIABILITY
Pay-as-you-go	Smallest cash payment amount (only actual health and dental premiums for retired employees). Improves short-term cash-flow situation.	Largest annual OPEB expense reported in the financial statements and highest long-term cost.	Largest and fastest-growing liability reported in the financial statements.
Partial-funding	Cash payment of more than the actual health and dental premiums for retired employees but less than the full actuarially required amount. Allows plan assets to start accumulating for future benefits, but it may reduce short-term cash flows.	Annual OPEB expense between that of the pay-as-you-go and the full-funding approach.	Smaller and slower-growing liability than the pay-as-you-go funding method, but larger than the full-funding approach.
Full-funding	Largest cash payment required (full actuarially required amount). Negatively affects short-term cash flows.	Smallest annual OPEB expense reported in the financial statements and lowest long-term cost.	No liability reported in the financial statements if fully funded from the year of implementation of Governmental Accounting Standards Board (GASB) Statement No. 45.

Source: *State of California Retiree Health Benefits Program: GASB Nos. 43 and 45 Actuarial Valuation Report As of June 30, 2008* (dated September 15, 2008).

Partial or full funding of OPEB results in lower costs and liabilities than does pay-as-you-go funding because the partial- or full-funding methods allow the employer to use a higher assumed rate of return in its actuarial calculations. The assumed rate of return is a primary variable influencing the calculation of the annual required contribution and total OPEB liability, and actuaries determine this rate using a long-term perspective.

Table 13 provides a practical illustration from the State's second actuarial study that shows how the State's funding policy affects the assumed rate of return and, by extension, the annual required contribution and the recognized OPEB liability for fiscal year 2008–09. Although prefunding has clear advantages, the budget crisis precipitated by the economic downturn has led to a shortfall in revenues for the State, and this shortfall has created cash-flow difficulties and made the State's ability to fully fund OPEB less feasible in light of competing fiscal priorities and limited resources.

Table 13

Comparison of the Effects on Liabilities of California's Contributing Different Levels of Cash Payments for Other Postemployment Benefits
Fiscal Year 2008–09
(Dollars in Billions)

	FUNDING METHOD		
	PAY-AS-YOU-GO FUNDING POLICY	PARTIAL-FUNDING POLICY (50 PERCENT)	FULL-FUNDING POLICY (100 PERCENT)
Assumed rate of return on investments*	4.50%†	6.125%	7.75%
Total Estimated Liability for Other Postemployment Benefits (OPEB) as of June 30, 2008	**$48.22**	**$38.30**	**$31.17**
Savings over pay-as-you-go funding policy	-	9.92	17.05
Annual Required Contribution	**$3.72**	**$3.09**	**$2.68**
Savings over pay-as-you-go funding policy	-	0.63	1.04
Expected Employer Cash Payments	**$1.36**	**$2.02**	**$2.68**
Projected OPEB Liability for Fiscal Year 2008–09	**$4.71**	**$3.44**	**$2.39‡**

Source: *State of California Retiree Health Benefits Program: GASB Nos. 43 and 45 Actuarial Valuation Report As of June 30, 2008* (dated September 15, 2008).

Note: The University of California and trial courts had separate actuarial studies performed so the amounts in this table excluded these public entities.

* Governmental Accounting Standards Board Statement No. 45 requires that employers use the long-term assumed rate of return on the investments that employers expect to use to pay OPEB benefits as they come due.

† Although the actuarial study based this 4.5 percent for the State's pooled money investment account on a long-term perspective, the actual rate of return on these underlying investments will vary and was only 1.8 percent in March 2009.

‡ Under the full-funding policy, this amount is any previously recognized OPEB liability for prior fiscal years (in this case, only fiscal year 2007–08), with interest and actuarial adjustments.

As Table 13 indicates, if the State were to commit to fully funding OPEB in fiscal year 2008–09 and in future years, it would save an estimated $1.04 billion by reducing the State's annual required contribution in that fiscal year. It would achieve similar savings in subsequent fiscal years, which would lower by about $17.05 billion the total estimated OPEB liability. Even by committing to partially prefunding OPEB at 50 percent, as shown in Table 13, the State would save an estimated $630 million by reducing the annual required contribution that fiscal year and, over time, would lower by about $9.92 billion the total estimated OPEB liability. Thus, in both the short term and long term, prefunding would provide significant savings to the State.

The State Is Exploring Prefunding Options

For all of the reasons discussed previously, one of the Commission's key recommendations is that the State establish prefunding of OPEB as a policy and budget priority. The governor endorsed the Commission's recommendations in May 2008. The governor directed Finance and Personnel Administration to research options that would allow the State to begin prefunding OPEB obligations without raising taxes or using General Fund money. Finance and Personnel Administration's complete analysis of these options was not publicly available at the time of our April 2009 report. However, in its April 2009 general obligation bond official statement, the State indicates the two agencies have identified four general approaches: (1) use lower-cost health-plan options, (2) direct contributions to an OPEB trust fund by active employees, (3) increase the vesting period for retiree health care benefits, and (4) use incentives to promote longer careers among state employees. In response to the first option, the fiscal year 2009–10 Governor's Budget anticipates partially prefunding OPEB beginning in fiscal year 2010–11 by using savings expected from contracting for lower cost health care coverage. According to the Governor's Budget, the savings would be about $180 million, which the State presumably would have put into a trust fund. However, the budget initially approved by the Legislature did not incorporate this proposal. The governor and Legislature will continue considering OPEB funding and other budgetary issues following an update of revenues and expenditures from Finance as part of the May revision of the budget. As a result, it remains unclear whether the State will begin prefunding OPEB obligations and how the State will manage the risks associated with its large and growing OPEB liability.

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Chapter 3

UPDATED ANALYSIS OF REMAINING ISSUES OF HIGH RISK AND DEPARTMENTS FACING RISK AND CHALLENGES

Chapter Summary

The risk issues described in this chapter, as well as the departments facing risk and challenges, remain on our high-risk list. In both high-risk issues—emergency preparedness and information technology (IT) governance—the State has made some progress, but additional work is needed. The departments included on the original Bureau of State Audits' (Bureau) high-risk list each continue to face risk and challenges: the California Department of Corrections and Rehabilitation (Corrections), the Department of Health Care Services (Health Care Services), and the California Department of Public Health (Public Health).

Although the State has made progress in various aspects of emergency preparedness since our first high-risk report in 2007, it must still address several other factors. Progress includes purchasing medical equipment and mobile hospitals, issuing planning guidance, and helping inform and prepare the public for emergencies. The State also formed the California Emergency Management Agency (CalEMA) in an attempt to streamline emergency preparedness. However, our review along with several other state and local reports issued in 2007 through 2009 revealed that the State is only partially prepared to respond to emergencies. For example, a 2009 report stated that California's public health workforce and laboratory capacity remain in need of significant attention.

The second high-risk issue is IT governance. The State continues its need to develop large information systems but lacks a mature governance structure and strategic plan. It recently took one of many steps toward its new vision of IT governance when the Legislature permitted to take effect the governor's proposal to reorganize four existing state IT departments and offices under the Office of the State Chief Information Officer (Information Office). Beginning January 2009, the Information Office published two volumes of its strategic plan; as of mid-May 2009 the Information Office was drafting and reviewing a third volume. Until it has measured itself against the plan, the Information Office's effectiveness is uncertain. Meanwhile, the State is moving forward with several large IT projects ranging in cost from $178.6 million to $1.6 billion, which presents risk to the State, including developing a product that meets the State's needs and managing the cost of each project.

Corrections, one of the high-risk departments we originally identified, continues to face significant risks and challenges in managing its responsibility to house, care for, and rehabilitate California's inmates. The department reports that as of March 31, 2009, overall capacity for its adult institutions was more than 192 percent of the system's design capacity of one inmate per cell. Corrections has embarked on several initiatives designed to reduce overcrowding, but these have provided little relief. Corrections' medical health care system remains in receivership of the U.S. District Court for the Northern District of California. In a February 2009 tentative ruling, a three-judge court formed under federal law opined that overcrowding was a primary cause of Corrections' unconstitutional system conditions, such as medical care, and expressed its intention to issue a prisoner release order to reduce overcrowding. Corrections still struggles to maintain consistent leadership: the governor appointed the fourth secretary for this department in the past three years, and more than 30 percent of top headquarters and warden positions were either vacant or filled in an acting capacity. Further, in fall 2008 Corrections stopped measuring progress against its existing strategic plan when, under the direction of the new secretary, Corrections began developing a new strategic plan; this plan is scheduled for completion in summer 2009.

Our original high-risk list included the Department of Health Services (Health Services), which split into two departments on July 1, 2007: Health Care Services and Public Health. The two new entities face challenges to ensure they meet legislative expectations to provide effective services and increase program accountability. Public Health is also challenged to elevate the visibility and importance of public health issues. Although each department, in an effort to meet these expectations, has engaged in strategic planning and implemented those plans in 2008, more time is needed to determine their effectiveness. The Legislature expected Health Services to implement the split with no overall increase in state funding, except for possible adjustments prompted by changes to either caseload or inflation. In fiscal year 2007–08 budgeted resources for the two new departments exceeded Health Services' fiscal year 2006–07 budget. The deputy director for the administration division at Health Care Services asserted the adjustments made to Health Care Services' and Public Health's budget were for reasons independent of the split. Notwithstanding the deputy director's comments, it is nearly impossible to determine which budget adjustments would have occurred under Health Services had the split not taken place.

Emergency Preparedness

Although the State has made progress in various aspects of emergency preparedness since our first high-risk report in 2007, several other factors, including a recent reorganization of state offices, continue to be addressed. Thus, emergency preparedness remains on our list as a statewide risk issue.

California's emergency preparedness system, which links the State in mutual-assistance agreements with local governments and federal emergency preparedness agencies, must address a wide range of potential emergencies, some of which can be catastrophic in their effect on public health, safety, and economic well-being. Potential emergencies can be single, short-term events, such as major earthquakes and fires in densely populated areas. They can also be prolonged emergencies; the medical community has warned that a pandemic, such as one caused by influenza, could sweep the State, last for months, and challenge the capacity of hospitals and clinics to accommodate the sick. In addition to natural disasters, the State must be prepared for man-made events—like the terrorist attacks in September 2001 or the riots in Los Angeles in 1992.

About 40 state entities may be involved when the State responds to emergencies. CalEMA, Public Health, and the Emergency Medical Services Authority (Medical Services) are very heavily involved in preparing for emergency response. CalEMA is the new cabinet-level agency formed by the January 2009 merger of the Governor's Office of Homeland Security (State Homeland Security) and the Governor's Office of Emergency Services (Emergency Services). CalEMA is the lead agency for emergency management in California, maintains the State Emergency Plan, and coordinates the State's response to major emergencies in support of local entities. Public Health, formed in July 2007 from elements of the former Health Services, coordinates the State's overall public health preparedness and response efforts and maintains California's public health emergency plans. Medical Services continues to be responsible for planning and coordinating California's medical response to disasters and providing medical resources to local governments in support of their disaster response.

CalEMA is the new cabinet-level agency formed by the January 2009 merger of the Governor's Office of Homeland Security and the Office of Emergency Services.

In our 2007 high-risk report, we pointed out that the Bureau had issued five audit reports related to emergency preparedness since 2002 and that each report had identified weaknesses in one or more of the four elements of emergency preparedness: planning, training, corrective action, and equipment and resources. Examples of weaknesses we cited included the State not sufficiently testing its medical and health response systems as part of annual response exercises and the lack of streamlining and adequate definition of its organizational structure for emergency preparedness. Our high-risk report also cited weaknesses the departments identified, including limited resources for equipment and insufficient efforts to make the public aware of the risks posed by emergencies.

Progress in Emergency Preparedness

The State has made progress in several aspects of emergency preparedness since 2007, such as securing funding for medical equipment and updating the medical response plan for disasters.

The State has made progress in several aspects of emergency preparedness since 2007. For instance, regarding enhancing preparedness in the medical care sector, a January 2009 report titled *First Year Checkup: Strategies for a Stronger Public Health Department* issued by the Milton Marks Commission on California State Government Organization and Economy (Little Hoover Commission) states that Public Health secured for the State $214 million in budget authority to purchase 50 million respirators, 3.7 million courses of antiviral medications, 2,400 ventilators, supplies and equipment for 21,000 alternate-care-site beds, and three 200-bed mobile field hospitals. According to the chief of its Disaster Medical Services Division, Medical Services purchased the mobile hospitals in 2007 and maintains them in locations around the State ready to be deployed when emergencies strike. He also stated that Medical Services has set up a mobile hospital as part of a broader medical response during emergency exercises held in August 2007 and November 2008. He mentioned that during the November 2008 exercise, medical staff assigned to the mobile hospital treated and held overnight about 100 "casualties."

Further, both Medical Services and Public Health issued guidance to assist the medical sector in planning for emergency responses. In September 2007 Medical Services issued its updated California Disaster Medical Response Plan (response plan), which includes the California Medical Mutual Aid Plan. This response plan provides California's disaster medical system with a comprehensive framework for disaster medical preparedness and response. It applies to medical preparedness and response for all disasters, regardless of type, with direct, indirect, or threatened consequences that may require medical resources beyond those available to the affected jurisdictions. The response plan states that it provides general policies and procedural guidance for coordinating support to local medical emergency response operations during disasters. In December 2008 Medical Services issued its California Disaster Medical Operations Plan, which provides operational guidance for the response plan. Also, in February 2008 Public Health issued standards and guidelines for health care "surge" during emergencies. During emergency events, health care systems must convert quickly from their existing patient capacity to surge capacity—a significant increase beyond usual capacity—to rapidly respond to the needs of affected individuals. According to Public Health, the guidelines will help communities as they plan how to sustain a functioning health care system following a catastrophic event such as a severe earthquake, bioterrorism attack, or outbreak of pandemic influenza. In fact, according to Public Health's deputy director for its Emergency Preparedness Office, California's ability to respond quickly to the recent outbreak of the H1N1 virus, first identified in California, is due to the vast progress made by local departments and Public Health over the last eight years.

The State has also taken action to help inform and prepare the public for emergencies. For instance Public Health started a Web site—www.bepreparedcalifornia.ca.gov—to provide information to the public regarding preventing and responding to emergencies. Public Health stated that the Web site is designed to be the "go-to" online resource to help Californians prepare for a public health emergency. The Web site has various sections that provide guidelines and tips for Californians on preparing for emergencies, provide information about different types of public health emergencies, and identify resources from which the public may obtain services during public health emergencies.

Another action the State has taken is the merger of Emergency Services and State Homeland Security into CalEMA. Effective January 1, 2009, the State merged the two offices to help streamline emergency preparedness. In April 2009 CalEMA's chief of staff and deputy secretary told us that the new agency was developing internal policies and procedures and was continuing to put in place its foundation and organizational structure. He also expected CalEMA to issue a final strategic plan by June 30, 2009.

Factors Still Being Addressed

Emergency preparedness involves activities at the local and state levels. Notwithstanding the progress described earlier, other factors related to emergency preparedness at both levels remain to be addressed.

Other factors related to emergency preparedness at both local and state levels remain to be addressed.

Factors Being Addressed by Public Health

According to the most recently available information, local health departments are not fully prepared for emergencies. In November 2007 Public Health released a report titled, *Emergency Preparedness in California's Local Health Departments: Final Assessment Report*, which summarized the results of an assessment by the Health Officers Association of California of public health emergency preparedness at local health departments. The report concluded that, although strengths existed and improvements in emergency preparedness had been made since September 2001, local health departments were only partially prepared to respond to emergencies and were still developing capacity to perform many required tasks. Identified areas needing improvement include the following:

- Local pandemic influenza plans in general need more work and have suffered from a lack of clear direction from both federal and state guidance.
- Most local health departments have not evaluated for timeliness and response capacity their system for any-time notification or alerting of at least 90 percent of the public health emergency response team and key stakeholders.
- Very few local health departments have exercised activating a fully functional operational area[13] to assess and document the ability to activate within a three-hour time frame.
- Many laboratories have vacant public health microbiologist positions that impact their capability to perform testing, one-third of public health laboratories have only part-time directors, and some public health laboratories face downsizing or elimination. Reduced capability at the local laboratory level will result in a lack of preparedness to address future bioterrorism and infectious disease emergencies.
- Many local health departments have challenges in reaching their special populations, and they are still working on ways (for example, alternative communication mechanisms) to get information to groups such as the homebound, developmentally disabled, and hearing or vision impaired.
- Most local health departments do not have formal agreements with local hospitals, urgent care centers, and tribes for the provision of mutual aid and surge capacity. Staffing for surge capacity is a major problem for most hospitals.

The report made 69 recommendations for areas needing improvement, including the following:

- Local health departments should ensure that their after-hours system for reporting an urgent referral or report regarding a communicable disease or terrorist event operates efficiently anytime.

[13] The State Emergency Plan defines an "operational area" as an area encompassing a county's boundaries and all political subdivisions within that county, including special districts.

- Local health departments should increase planning efforts, particularly communication links, for special populations such as the homebound, frail elderly, physically and developmentally disabled, hearing and visually impaired, and individuals in skilled nursing facilities and other institutions.

- Health Services[14] should reestablish the state laboratory training program to ensure that a sufficient number of trained microbiologists exist.

- Health Services should consider evaluating local health departments periodically concerning their capacity for emergency preparedness.

In response to this report, Public Health convened a steering committee to prioritize and comment on the future direction for each recommendation. The steering committee was made up of state and county officials and met from February through August 2008. Based on our review of the most recent information from Public Health—a September 2008 report related to the steering committee's results—it is apparent that additional work needs to be completed. Although the steering committee concluded that some of the recommendations had been implemented and that nearly a third of the recommendations were either not a priority or a low priority, 35 percent of the recommendations were a medium or high priority, and another 23 percent were high priorities requiring maintenance and ongoing funding.

Another report indicates that the State is not fully prepared for emergencies. In its January 2009 report, the Little Hoover Commission identified areas to improve in California's public health system. It concluded that the State must prioritize public health as a core component of public safety, equal to fire and police. As such, the leadership of Public Health must forcefully make the case for budget priorities that reflect the department's public safety role and that public safety must be a top priority. The Little Hoover Commission also stated that California's public health workforce and laboratory capacity remain in need of significant attention. The State's difficulty in hiring workers in the public health profession is compounded by salaries that are lower than those in the private sector and even local public health departments. The inability to fill positions, coupled with repeated budget cuts, has resulted in the state laboratory closing one of its units, eliminating the State's ability to provide more than two dozen laboratory tests previously

The Little Hoover Commission reported that the inability to fill positions, coupled with repeated budget cuts, has resulted in the state laboratory closing one of its units, eliminating the State's ability to provide more than two dozen laboratory tests previously conducted at the state level.

[14] The assessment by the Health Officers Association of California was prepared when Health Services still existed. When Public Health came into existence in July 2007, it took over responsibility for recommendations to Health Services.

The Little Hoover Commission's recommendations to the California Department of Public Health (Public Health) included the following:

- Public Health should partner with all three public higher education systems to fill the pipeline for public health workers and educate and link students with public health opportunities at the department.
- Public Health should facilitate consolidation of county laboratories into regional laboratory programs.
- Public Health should determine its laboratory capacity priorities and request the State to lift its barriers to workforce development, such as microbiologist salary structures that cannot compete with private and county laboratories.

Source: *First Year Checkup: Strategies for a Stronger Public Health Department,* Little Hoover Commission, January 2009.

conducted at the state level. The Little Hoover Commission commented that, given continuing concerns about the threat of a biological attack, as well as the potential for avian and pandemic flu, a strong state laboratory is critical to the State's ability to identify and quickly respond to disease-based emergencies. See the text box for key Little Hoover Commission recommendations.

In an April 2009 discussion, the special assistant to Public Health's director told us that Public Health is taking several actions to implement the Little Hoover Commission's recommendations. These actions include working with the U.S. Centers for Disease Control and Prevention, the University of California, and other entities to implement projects intended to help grow and maintain the public health workforce, and convening a work group to address laboratory issues including workforce. She also stated that one option the work group will consider is consolidating public health laboratories into regional laboratories.

Also, Public Health has recognized the importance of emergency preparedness as one of its responsibilities and that certain aspects of emergency preparedness need to be addressed in the near future. In its strategic plan for 2008–2010, the first since its creation in 2007, Public Health placed great importance on the concept of emergency preparedness. In this plan, Public Health established preparing for and responding to public health emergencies as one of its six core activities. Further, Public Health established one of its five broad goals as preparing the State to address public health emergencies and emerging threats. Through its objectives for this goal, Public Health identified key performance measures to be addressed by 2010. These performance measures include the following:

- Increasing to two by June 30, 2009, the number of state-level exercises with a public health component or health care surge component with completed after-action reports and successful completion of corrective action plans, and maintain that level of annual activity by June 30, 2010.
- Increasing to 43 (out of 63) by June 30, 2009, the number of local health departments with a rating of at least 70 percent on their Strategic National Stockpile, and to 54 by June 30, 2010.[15]

[15] According to the Health Officers Association of California, the mission of the Strategic National Stockpile program is to ensure the availability and rapid deployment of pharmaceuticals, antidotes, other medical supplies, and equipment necessary to counter the effects of nerve agents, biological pathogens, and chemical agents.

- Increasing to 80 percent by June 30, 2009, the percentage of Public Health's staff and managers who have successfully completed training in National Incident Management System/Standardized Emergency Management System and Joint Emergency Operations Center positions and are available for deployment, and to 90 percent by June 30, 2010.

Finally, Public Health recognizes that funding challenges lay ahead. According to the deputy director for its Emergency Preparedness Office, federal grants for public health emergency preparedness have decreased approximately 25 percent in the last three years. She mentioned that such reductions will affect preparedness for both state and local health departments.

A Public Health official commented that federal grants for public health emergency preparedness have decreased approximately 25 percent in the last three years.

Factors Being Addressed by CalEMA

Public entities at both the local and state levels also are not fully prepared for emergencies. Consultants provided Emergency Services an October 2007 report, titled *California State Emergency Services Gap Analysis: Baseline, End State, and Gaps in Preparedness,*[16] which concluded that although California has made moderate efforts toward achieving the desired level of preparedness, its cities, counties, and state agencies were not fully prepared to prevent, protect against, respond to, or recover from a catastrophic event. This report presented the results of a survey showing a score indicating the current level of preparedness for responding to a catastrophic event by entities such as operational areas and state agencies. With a preparedness goal, or score, of 5 indicating "fully prepared," the report concluded that the score for operational areas was 3—indicating "moderate progress" toward emergency preparedness—and the score for state agencies was 2.4—indicating "initial efforts and resources underway."

Regarding preparedness assessment, CalEMA identified two activities undertaken since the issuance of the gap analysis report. First, CalEMA's assistant secretary for planning, protection and preparedness (assistant secretary) stated that the gap analysis

16 A gap analysis attempts to identify the shortfalls between what resources are available and what will be needed in a catastrophic event. Resources include physical supplies, staffing, strategies, services, systems, and plans.

Latest developments:

The May 2009 Jesusita Fire in Santa Barbara County underscores the importance of emergency preparedness. The wildfire burned out of control for several days, and at its peak, 30,500 Santa Barbara city and county residents were evacuated from their homes, with an additional 29,000 residents under evacuation warnings. Over 4,300 fire personnel were on scene with hundreds of pieces of equipment to fight the fire on the ground and from the air; the fire consumed numerous homes and charred more than 8,700 acres.

Source: County of Santa Barbara Web site at www.countyofsb.org.

was a key starting point for more finite efforts to measure emergency preparedness throughout the State. She stated that after the gap analysis, CalEMA initiated the Metrics Project, which supports standardized resource and capabilities inventories and assessment. She also stated that the assessment will be accomplished through an objective, systematic identification of gaps in prevention, planning, and response capabilities to establish more effective allocations of resources in emergencies. She added that the Metrics Project is targeted to result in specific deliverables, such as a common format and repository for data, including quantity, capability, and location of specific resources. CalEMA believes that a key project milestone will be the integration of resource management systems into its forthcoming statewide information management software replacement.

Second, the assistant secretary mentioned that recent legislation that enhances the role and functions of the California Emergency Council also provides a means to measure preparedness status and effectiveness. The California Emergency Council, composed of both statutory and appointed members, is an advisory body to the governor; it is required to publish a biennial report of the state of emergency preparedness for catastrophic disasters. The assistant secretary stated that the report will include a summary of strategic actions necessary to address identified gaps, as well as an evaluation of prior efforts to close gaps that have been identified in previous reports, audits, and independent analyses.

Information Technology

The Bureau included IT governance in its May 2007 inaugural high-risk list because, despite efforts to establish statewide governance, the State had lacked strong IT oversight for many years. Without strong statewide oversight and a clear vision of its IT needs, the State is at risk for ineffective and improper IT investment and use. The Bureau reported that the functions and level of responsibility for the governance model that existed at that time were not clear. The fiscal year 2007–08 Governor's Budget laid out an aggressive agenda for the state chief information officer (state CIO) and proposed to expand the office's role. However, the Legislative Analyst's Office (Analyst's Office) warned that the state CIO potentially would have no authority to fund projects, that this authority would remain with the Department of Finance (Finance), and that the budget lacked IT goal prioritization.

Governance and Oversight

IT governance and oversight remain a high-risk issue. The State continues to need to develop large information systems but has lacked a mature governance structure or a strategic plan to do so. In recent years, the governor established an Information Office and appointed a state CIO. However, as of May 2009, the state CIO is just beginning to put in place a statewide governance model and strategic plan.

In 2006 the Legislature passed and the governor signed into law Senate Bill 834 (Chapter 533, Statutes of 2006). This law created the Information Office, to be headed by a state CIO, a cabinet-level position. On December 6, 2007, the governor announced the appointment of the new state CIO, and the Information Office began formal operation in January 2008. As Table 14 shows, the Information Office's budget and number of proposed positions have both increased. However, the table is not reflective of the reorganization we discuss later.

Table 14
Information Office Proposed Budget and Positions
Fiscal Years 2007–08 Through 2009–10

FISCAL YEAR	GOVERNOR'S PROPOSED BUDGET (IN MILLIONS)	NUMBER OF POSITIONS
2007–08*	$7.9	46.5
2008–09	6.7	32.3
2009–10	16.1	64.6

Source: Governor's proposed budget, fiscal years 2007–08, 2008–09, and 2009–10.

* Fiscal year 2007–08 actual expenditures were $2.6 million and the number of positions was 11.1.

State law defines the state CIO and Information Office's role as including the following: advising the governor on the strategic management and direction of IT resources; establishing processes to ensure the efficiency and effectiveness of state IT systems and services; producing and implementing an annual IT strategic plan; and providing IT project approval, suspension, termination, and oversight. According to the Information Office's report summarizing IT projects under construction, as of March 2009, it was overseeing 111 projects with projected total costs of more than $7.6 billion.

In February 2009 the governor issued a plan to reorganize statewide IT governance by consolidating IT functions under the state CIO. In May 2009 the Legislature allowed to take effect the governor's proposed reorganization. The reorganization merges four existing state IT departments and offices and transfers key functions, such as enterprise IT management and information security, data center and shared services, and IT procurement policy, into an expanded Information Office.

The IT reorganization sets up the state CIO's *federated* governance model. The state CIO envisions a federated governance model in which the State, agencies, and departments maintain authority and accountability for their respective government levels. Specifically, at the enterprise or statewide level, the Information Office will provide IT infrastructure and shared services, and will engage in IT project management oversight; agencies will provide program policy and direction, prioritize investments, and consolidate resources; and departments will provide daily operations and support. The state CIO believes that the federated governance model provides a framework for technology leadership and ensures the integrated and strategic use of technology resources statewide by bringing together the State's key IT policy and operating functions into a single organization.

Both the Little Hoover Commission and Analyst's Office reviewed and commented on the proposed IT reorganization. The Little Hoover Commission noted in its report, titled *A Review of the Governor's Reorganization Plan to Consolidate Information Technology Functions* dated March 2009, that with the reorganization the Information Office under the state CIO would be in charge of IT procurement policy. According to the Little Hoover Commission, transferring the policy duties to the Information Office would allow the State to establish architectural standards, common requirements, and uniform specifications for IT goods and services across all agencies, which would lead to cost savings. The Little Hoover Commission further described the reorganization plan as firmly establishing the Information Office at the center of decision making for IT investment and deployment.

In its March 2009 review, the Analyst's Office raised potential concerns stating the reorganization may limit state entities' choice in purchasing IT goods and services, limit the pool of potential vendors, and create a bureaucracy. However, ultimately, the Analyst's Office concluded the benefits of the reorganization outweigh these concerns.

In our inaugural high-risk report we presented the Analyst's Office's concern that the state CIO would not have the authority to fund IT projects, and that this authority would remain with Finance. The Analyst's Office did not raise this concern in its March 2009 analysis of the reorganization. In addition, a September 2008 memorandum of understanding between the Information Office and Finance describes the process by which they will coordinate with each other on issues, fund conditions, and program or other priorities that may affect an IT proposal.

Beginning in January 2009 the state CIO released the first of three volumes outlining the State's IT strategic plan. Volume One, titled *California Information Technology Strategic Plan: Strategic Concepts, Strategies, and Goals,* discusses organization and governance of technology in the State and lays out strategic concepts for building successful IT programs in California over the next decade. *Statewide Information Technology Capital Plan: Transforming Strategic Goals into Actions,* which the state CIO issued subsequently, comprises Volume Two and represents the State's plan for IT investments over the next five years. As of mid-May 2009, the Information Office was drafting and reviewing Volume Three.

Volume One outlines six strategic concepts with which the Information Office intends to direct state IT performance. The six strategic concepts are presented in the text box. This volume provides specific strategies for each of the strategic concepts, and each strategy is composed of goals for the Information Office to accomplish in order to meet its strategies. Examples of the specific goals include establishing a Web portal that provides a comprehensive list of government e-services, establishing data and information-sharing policies and procedures, and ensuring periodic and structured testing of backup and recovery systems.

To develop Volume Two, the Information Office reviewed agency and department IT capital plans. Within the individual plans, agencies and departments prioritized their proposed IT investments, and agencies attempted to identify opportunities to leverage common or similar activities across their organizations, which is in line with the federated governance model. The Information Office included proposals for projects that aligned with Volume One's strategic concepts and considered agency priorities and fiscal policy during the selection process.

According to the Information Office's chief deputy director, Volume Three of the strategic plan will include specific metrics and timeframes for achieving the goals the Information Office presents in Volume One. As of mid-May 2009, the Information Office stated it was drafting and reviewing Volume Three. Although the Information

Strategic Concepts to Be Used by the Information Office and Their Intended Purposes

- **IT as reliable as electricity:** to make information technology so pervasive one takes it for granted.
- **Fulfilling technology's potential to transform lives:** to deliver better results while meeting growing expectations.
- **Self-governance in the digital age:** to make government transparent, available, and intuitive via technology.
- **Information as an asset:** to make information useful (for example, accessible, searchable, understandable, and shareable).
- **Economic and sustainable:** to lower costs and save the planet.
- **Facilitating collaboration that breeds better solutions:** to encourage communication and collaboration to maximize information exchange and improve decision making.

Source: California Information Technology Strategic Plan, Volume One.

Office has not published its metrics, the chief deputy director provided us with an internal document he stated the Information Office uses to track the strategic plan's implementation, which includes action items and timeframes.

Information Technology Projects

The State wasted taxpayer money by mismanaging the federally-required Child Support System. The State paid about $1 billion in federal penalties for its eight-year delay in implementing the system in addition to spending $111 million on an earlier attempt of developing the system.

The State's IT projects can be significant in scope and cost. Governance and oversight are key to keeping these projects on track and on budget. For example, in its initial efforts to obtain federal certification for its Child Support Automation System (Child Support System), the State mismanaged the project and wasted taxpayer dollars. Specifically, the State paid about $1 billion in federal penalties for its eight-year delay in implementing the Child Support System, a single statewide system designed to give state and county child support agencies the necessary tools to manage and track child support cases statewide.[17] In addition, the Department of Social Services had abandoned its earlier attempt to develop the system after spending $111 million. Subsequently, the Legislature assigned the Franchise Tax Board to take on procurement, development, and other responsibilities and to restart the project.

The Information Office has recently taken action intended to strengthen the way IT projects are managed, and to avoid such problems. In April 2009 the Information Office released a policy letter announcing the mandatory use of its *California Project Management Methodology* (project methodology) for state IT projects approved after January 1, 2009. The policy letter explains that the project methodology represents a significant step toward strengthening IT project management in the State and will serve as the State's IT project management standard. The project methodology includes two toolkits with standardized templates in Excel format that agencies and departments will use to develop and assess IT concepts and to initiate, plan, execute, and close an IT project. The policy letter also states that all projects will submit standardized status reports. These status reports summarize project milestones and indicate whether the project is on track or experiencing variances in its schedule, deliverables, or costs. In its April 2009 policy letter, the Information Office stated it will require periodic status reports as part of its current project oversight role.

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[17] As of 2006 the State had paid about $1.2 billion in federal penalties. In 2008, upon the system obtaining federal certification, the State received a rebate of $193 million from the federal government.

Some examples of large information technology projects that the State is currently engaged in include the 21st Century Project, Financial Information System for California, and the Strategic Offender Management System. The projects range in cost from $178.6 million to $1.6 billion, and represent a sizable investment and risk for the State. These three projects are representative of the State's IT needs, and other projects of similar size and scope are no doubt on the State's horizon. Because the proposed scope and cost of the State's IT projects are significant, effective governance and oversight of development and implementation are critical.

21st Century Project

The State's 21st Century Project has not progressed smoothly, adding to the inherent risk. Currently, the State uses a variety of IT systems to process, store, and report on its payroll, employment history, leave, position, and attendance data. The 21st Century Project is intended to replace these outdated systems and integrate the functions. In 2004 Finance approved the feasibility study report supporting the concept and plan for this project. The State Controller's Office (Controller) is leading the project. Between 2005 and the end of 2008, the Controller selected project software, contracted with a systems integrator, and began initial systems development and integration. However, the Controller had ongoing disagreements with its system integrator, BearingPoint, Inc. (BearingPoint), and in early January 2009, the Department of General Services, on behalf of the Controller, notified BearingPoint that the Controller was terminating its agreement for failure to meet contractual agreements. Nevertheless, the Controller is moving forward with the 21st Century Project. In order to replace BearingPoint, the Controller is conducting a two-stage procurement process. As part of stage one in April 2009, the Controller awarded two contracts for bidders to evaluate the existing system artifacts and prepare a proposal to complete the project. During stage two, the Controller plans to award a contract to complete the 21st Century Project as reflected in one of the bidders' final proposals. The Controller expects to complete the second stage by November 2009.

The State's 21st Century Project—the system that will replace outdated personnel and payroll related systems and integrate functions—has not progressed smoothly and has proven costly. The cost of the project increased by $46.6 million to a total projected cost of $178.6 million as of May 2008.

The 21st Century Project has proven costly for the State, and implementation has been delayed. Between May 2004, when the feasibility study report was approved, and May 2008, the projected cost of the 21st Century Project increased by $46.6 million to a total of $178.6 million. The Controller reports that as of February 2009, it has incurred costs of $82.2 million since the project began, of which $25.8 million was paid to BearingPoint. The Controller began pursuing a claim in April 2009 against BearingPoint's surety, stating BearingPoint was in default of the contract and could recoup as much as $25.2 million if its claim is successful. However, the full cost of completing the project after having terminated BearingPoint is unknown. According to the Controller's 21st Century Project manager, the cost and timeline are contingent upon the new system integrator and will not be known until fall 2009 when the procurement is complete. The Controller estimates that, at the time of contract termination, BearingPoint was between 21 and 24 months behind the statewide implementation completion date of June 2009 which was initially proposed.

Financial Information System for California

The Financial Information System for California (FI$Cal) is complex and costly—it was projected to cost the State $1.6 billion, and costs are being further revised.

The Financial Information System for California (FI$Cal) is also costly and complex, and the State continues to evaluate the best approach to designing and implementing this system. Finance is the lead agency in developing FI$Cal, a system that is intended to include state budgeting, accounting, financial reporting, and grant and human resources management capabilities. In a November 2007 special project report, FI$Cal was projected to cost the State $1.6 billion. As of May 2009 its project team was in the process of revising the FI$Cal project budget and schedule.

According to the Information Office's chief deputy director, as of March 2009 FI$Cal is the most significant project with which the Information Office has been involved; its role is to ensure that FI$Cal is appropriately staffed and scoped. A letter the FI$Cal project sent to the Analyst's Office also gives an example of how the Information Office is engaged in the project. The Information Office requested that FI$Cal engage a consultant to review its structure and approach as a way to minimize project risk. Based on the review, one recommendation was to make the state CIO a voting member of the FI$Cal steering committee.

The Bureau is also engaged in project oversight. In September 2007 it took over the administration of Finance's contract with an entity providing independent oversight of FI$Cal, as required by a 2007 Budget Act trailer bill. The trailer bill required the Bureau to monitor the contract, including assessing whether the concerns of the contractor were being addressed, and to periodically report to the Legislature on the contract. The original contract expired September 30, 2008, and the FI$Cal project has not yet retained a new independent oversight contractor. On September 30, 2008, the Legislature approved legislation requiring the Bureau to independently monitor the FI$Cal project through system development, as deemed appropriate by the state auditor. The Bureau's responsibilities include, among other things, monitoring the contracts for independent project oversight and independent verification and validation services, and assessing whether the

FI$Cal project is progressing according to schedule and within budget. As part of monitoring the FI$Cal project, the Bureau attends oversight, steering committee, and other relevant project meetings. In addition, the Bureau is required to report to the Legislature on the status of the FI$Cal project at least annually; the last update was in January 2009.

In mid-May 2009, the FI$Cal project reported to the Analyst's Office the status on the project. According to the letter, FI$Cal had just received from its consultant a review it performed in the context of best practices for planning and implementing a large enterprise resource planning project. The review was comprised of five components, including proposed project objectives, business requirements, and project implementation. In its letter to the Analyst's Office, the FI$Cal project stated, based on the consultant's recommendations, that it will change its implementation strategy, implementing the project in waves that successively expand to handle additional business functions and departments. The FI$Cal project concluded that this approach will significantly lower its risk and cost. The project will also execute its procurement in two stages, with the first stage resulting in awards to two bidders to conduct a paid "fit-gap" analysis as the basis for software and implementation bids. The FI$Cal project stated that it will focus in fiscal year 2009–10 on developing its procurement and implementation approaches and issue its request for proposal.

In response to an Analyst's Office recommendation that the FI$Cal project and the 21st Century Project analyze the feasibility of merging, the Controller, the Information Office, and the FI$Cal project proposed merging the projects' two steering committees into a joint committee. The entities stated that the projects are in very different project lifecycle stages and that merging the two projects at the working level would increase project cost and risk. However, the Controller, the Information Office, and the FI$Cal project believe a joint steering committee would allow a coordinated and comprehensive approach to strategic decision making for both projects regarding scope, schedule, cost, risk mitigation strategies, and project coordination and collaboration.

Strategic Offender Management System

Similar to the Controller, Corrections has multiple systems for storing and tracking data. The Strategic Offender Management System (SOMS) is in its early implementation stages, and Corrections will likely be challenged to integrate the many disparate systems it is currently operating. According to its system request for proposal, Corrections relies on paper files and more than 100 small, stand-alone applications, subsystems, and tools to

The Strategic Offender Management System, which is intended to integrate many disparate systems at Corrections, is projected to cost $416.3 million and be complete in December 2012.

support its offender management process. Corrections proposed SOMS to integrate these systems. In April 2009 it completed the vendor procurement stage and announced its intent to award the vendor contract. Corrections anticipates that it will complete implementation of SOMS in December 2012, with some business functionality available no later than one year after it signs a contract with the vendor. According to the Information Office, as of March 2009 SOMS was projected to cost $416.3 million.

Corrections stated that it maintains responsibility over the implementation of SOMS but is working with the Health Care Receivership (receiver), whose role we discuss further in a later section, on the early implementation stages. The receiver will rely on certain SOMS data and functionalities to support its health care system, including the unique tracking number SOMS will use to provide access to each inmate's service and program records. The receiver became involved in SOMS, in part, to expedite the procurement process for Corrections. The receiver made a filing on Corrections' behalf requesting the court that appointed the receiver to waive state contracting statutes, regulations, and procedures for SOMS. The court granted the waiver in April 2008, and in doing so noted that the receiver would be hampered in its ability to achieve the tasks set forth by the court, specifically, achieving a constitutionally adequate medical care system in a timely fashion, without such a wavier.

In addition to expediting the SOMS procurement, the waiver exempted SOMS from the Information Office's project oversight. However, both Corrections and the Information Office stated that the Information Office is involved with SOMS. According to its chief deputy director, the Information Office initially approved SOMS and continues to offer advice on the project. Corrections told us that it uses the status report functionality within the Information Office's project methodology, and will submit these reports to the Information Office beginning May 2009.

California Department of Corrections and Rehabilitation

Prison overcrowding remains a risk to the State. Assembly Bill 900 (AB 900), which was signed into law in 2007 (Chapter 7, Statutes of 2007), authorizes Corrections to construct and renovate (construct) prison space, and to initiate and improve rehabilitation programs to reduce prison overcrowding. However, AB 900 construction, along with other initiatives Corrections is using, such as transferring inmates to out-of-state prisons, has thus far provided little relief for prison overcrowding. Restoring the prison medical care delivery system remains a risk to the State as well. Although the court-appointed receiver reports some success, it has also reported challenges in making necessary medical care changes in the State's prison system. Additionally, Corrections is not currently measuring its operations against a formal strategic plan and has lacked consistent leadership because of vacancies and acting appointments in high-level headquarters and warden positions.

Overcrowding

Overcrowding remains severe in the State's prisons. According to Corrections' data from March 31, 2009, more than 168,600 male and female adult inmates are Corrections' responsibility. Of these, about 90 percent (152,334) are housed in California institutions and about 4 percent (6,662) are housed out of state; the remaining 6 percent (9,675) are generally housed in camps, community correctional centers, and state hospitals. Corrections' data also show that its institutions are at more than 192 percent overall design capacity; the individual occupancy rates range from a low of 122 percent at the California Medical Facility to a high of 230 percent at Deuel Vocational Institution.

Several initiatives including AB 900 construction and transferring inmates to out-of-state institutions, which were meant to reduce overcrowding, have thus far been of limited effectiveness. AB 900 authorized the construction of facilities in two phases. Phase I is for the construction of 24,000 beds for infill and reentry, and facilities for medical, dental, and mental health purposes;[18] it is meant to provide prompt relief for prison overcrowding. Phase II is for construction over the long term of 16,000 beds for the same purpose as Phase I.[19] However, as of mid-April 2009, Corrections has not completed any of the planned Phase I construction. In fact, Corrections could not provide estimates of the earliest the facilities will be ready for occupancy.

Although AB 900 Phase I was meant to provide prompt relief to the State's prison overcrowding, planning and constructing prison facilities is a long, complex process. Corrections currently has a total of 19 projects for Phase I under consideration or in the approval process. Under consideration means that Corrections has determined a site is potentially viable, but it has not performed necessary preliminary planning such as infrastructure assessments or environmental reviews. The approval process Corrections must

[18] Infill beds are designed to replace the temporary beds currently in use (not intended to house additional inmates), and reentry beds provide housing for inmates within one year of being released from custody. AB 900 Phase I also includes facilities for medical, dental, and mental health services.

[19] Subsequent legislation passed in February 2009 (SB3X14) changed the original AB 900 language to authorize "up to" 24,000 beds in Phase 1 and 16,000 beds in Phase 2.

Approval and Funding Process for Assembly Bill 900 Phase I Construction Projects

1. **California Department of Corrections and Rehabilitation (Corrections)**—Produces documents including the plot plan, proposed staffing and space requirements, infrastructure and environmental reviews, and cost estimates.
2. **Department of Finance (Finance)**—Reviews the preliminary documents produced by Corrections and, if approved, forwards the package to the Joint Legislative Budget Committee.
3. **Joint Legislative Budget Committee**—Has 30 days to review documents and respond with questions that Finance and Corrections work together to address and resolve.
4. **State Public Works Board (SPWB)**—Approves cost, schedule, and scope of the proposed project, approves Corrections moving forward with an interim loan application to the Pooled Money Investment Board to be funded by the Pooled Money Investment Account.
5. **Pooled Money Investment Board**—Provides 12-month loans for the project approved by SPWB. Additional 12-month loans can be granted as needed.

Source: California Department of Corrections and Rehabilitation.

undergo is sequential and spans multiple departments and boards as shown in the text box. As of mid-April 2009, according to its acting director of Project Management and Construction Services, Corrections was ready or in the process of getting ready to submit six projects to Finance, two projects were at Finance, one was with the Joint Legislative Budget Committee, one had been approved for funding and one had been denied funding by the Pooled Money Investment Board, and eight were under consideration. Combined, these 19 projects, if completed, would accommodate a minimum of 8,169 inmates. However, according to the acting director, the soonest more than one-half of the beds will be ready for occupancy is 44 months after the Pooled Money Investment Board approves funding. Further, although Corrections received funding approval for the design phase of a small 50-bed project in mid-April 2009, the acting director was unsure when funding will be approved on the remaining 18 Phase I projects. Therefore, construction authorized by AB 900 is years away from completion, delaying relief from overcrowding in California's prisons.

According to Corrections' chief deputy secretary of Facility Planning and Construction, Corrections is cognizant of the importance of building capacity to address overcrowding. Despite AB 900 being urgency legislation—designed to take effect immediately upon the governor's signature—the chief deputy secretary believes that three issues have delayed implementation of the law. First, because AB 900 required technical adjustments, Corrections had to work with the Legislature to pass trailer bill language allowing Finance to approve AB 900 projects; the trailer bill language passed in February 2009. Second, the Taxpayers for Improved Public Safety filed a lawsuit and has since appealed it to the State Supreme Court. It is Corrections' understanding that until the lawsuit is resolved, the Pooled Money Investment Board will not consider AB 900 projects for funding beyond the 50-bed project it approved in mid-April 2009. Finally, the chief deputy secretary stated that, because of the State's fiscal condition, the Pooled Money Investment Board has been unable to sell lease revenue bonds to replenish its pooled investment account and to begin making loans to existing and new projects.

Another solution to reduce overcrowding is transferring inmates to out-of-state facilities. Like AB 900 construction, this program has provided little relief to the overall size of the prison population. With an emergency proclamation in October 2006, the governor allowed Corrections to transfer inmates out of state.[20] Since October 2006 Corrections has contracted with the Corrections Corporation of America (CCA) to house some of the State's inmates. Corrections has contracted with CCA for space at six facilities in four states—Arizona, Mississippi, Oklahoma, and Tennessee—and may transfer up to 8,132 inmates through June 2011. According to Corrections' data, as of March 31, 2009, the State has transferred more than 6,600 inmates out of state and a manager of the California Out-of-State Correctional Facility Unit told us that Corrections has plans to complete its transfers by the end of June 2009. The intent of transferring inmates out of state is to reduce prison overcrowding. However, the transfers provide only minor reductions to the in-state inmate population and the effect is temporary, lasting only as long as the relevant contract does.

What has the potential to have the most significant immediate impact on prison overcrowding is not a program that the State has devised and will implement but rather an anticipated prisoner release order from a three-judge court formed under federal law. The tentative ruling issued in February 2009 cites overcrowding as the primary cause for the unconstitutional conditions found in California's prisons, such as medical care, and that a prisoner release order may be the most compelling means for relief. The three-judge court stated that the plaintiffs arguing unconstitutional conditions had been denied these rights for up to 14 years and could not be expected to wait an undeterminable additional number of years for these rights to be restored. According to the three-judge court, federal law uses a prisoner release order as a broad term that has the purpose or effect of reducing or limiting the prison population, or directs the release from or nonadmission of inmates to prison. The tentative ruling proposes that the State cap its prison population at 120 percent to 145 percent of a prison's design capacity—one inmate per cell—and achieve

Latest developments:

In the May revision for the fiscal year 2009–10 governor's budget, the governor has made two proposals that may affect the State's prison population:

- Targeted Reductions in Prison Population—Approximately 19,000 undocumented immigrants are currently in the State's prisons, and the State believes the federal government has historically underfunded the State's cost to incarcerate them. The federal government is proposing to eliminate funding and instead augment resources to enhance border security. Unless the State begins receiving what it considers to be an appropriate amount of reimbursement from the federal government for the costs of incarcerating undocumented immigrants, it will begin approving, as appropriate, applications for commutation of sentences and having the undocumented immigrants deported by Federal Immigration and Customs Enforcement.
- Change Sentencing Options for Low-Level Offenders—This proposal would eliminate current sentencing options for certain crimes that may be treated as either felonies or misdemeanors, making them punishable by a jail term rather than a state prison sentence.

Source: Fiscal year 2009–10 May revision.

[20] A lawsuit filed to block the out-of-state transfers was subsequently settled in June 2008 when the court of appeal sided with the governor.

these levels over a two- to three-year period.[21] Based on Corrections' March 31, 2009, data and assuming a 120 percent cap was imposed on all institutions, that would represent a reduction of as many as 57,000 inmates. The State has responded to the three-judge court's tentative ruling, indicating its intention to appeal to the U.S. Supreme Court should the tentative ruling become final. As of May 2009 the three-judge court had not issued its final ruling.

To proceed with Phase II projects, Corrections must meet 13 benchmarks spelled out in the law, and a review panel must verify that it has met the benchmarks.

Phase II of AB 900 provides for prison construction and renovation over the long term. Although it may provide additional prison space, it will not affect Corrections' present overcrowding issues. In fact, to proceed with Phase II projects, Corrections must meet 13 benchmarks spelled out in the law, and a review panel must verify that it has met the benchmarks. The benchmarks cover a broad spectrum of objectives, such as the number of beds under construction for infill, reentry, and medical, dental, and mental health purposes; creation of the California Rehabilitation Oversight Board (C-ROB); and the implementation of a plan to address management deficiencies. However, a benchmark cannot be deemed complete until the review panel—consisting of the state auditor, the inspector general, and an appointee of the Judicial Council of California—considers the criteria for deeming it complete and then makes an assessment of Corrections' progress as measured by the criteria. According to the Bureau's chief counsel, the review panel has not yet met to consider the criteria for completion of each benchmark. However, legal counsel for each of these review panel members, as well as the Analyst's Office, are engaged in ongoing discussions about the process for convening the panel at the appropriate time. Thus, because the panel has not made its assessment of Corrections' progress in meeting the benchmarks, we cannot comment on Corrections' progress.

A significant focus of AB 900 is construction. However, the law links overcrowding to recidivism and to a lack of prison programs, including substance abuse treatment, education, and job skills training. To regularly examine the various mental health, substance abuse, educational, and employment programs for inmates and parolees, AB 900 established C-ROB within the Office of the Inspector General (Inspector General's Office). C-ROB consists of an 11-member board made up of state and local law enforcement, educators, and mental health or substance abuse professionals. It must report twice a year to the governor and Legislature about the effectiveness, in part, of Corrections' rehabilitative programming. C-ROB's assessment of Corrections' progress is based on 46 total recommendations and subrecommendations (recommendations) included in a June 2007 report titled *Expert Panel on Adult*

[21] Corrections' standard practice is to house two inmates in each cell.

Offender and Recidivism Reduction Program. Additionally, C-ROB assesses Corrections in such areas as the effectiveness of treatment efforts and gaps in rehabilitation services. In its March 2009 report, C-ROB found that Corrections had completed seven recommendations to improve its rehabilitative programming, 34 recommendations were in process, three were stalled pending passage of new legislation, and the status of two was unknown.

In early June 2009 Corrections' deputy chief of staff (deputy) spoke to us about some additional measures Corrections has taken, or plans to take, to reduce overcrowding. According to the deputy, Corrections has had success in reducing the number of *nontraditional beds*—the term used to describe beds in spaces that were not designed for bedding inmates such as gyms, hallways, and day rooms—the count for these nontraditional beds has dropped from 19,618 in August 2007 to 10,349 in June 2009. Additionally, the deputy stated that Corrections has a new policy of discharging from parole those parolees who, after release from prison, the federal government deports. Corrections further described its policy in a March 2009 press release stating that the policy is expected to reduce the number of parolees returned to state prison for the federal violation of illegally entering the United States after deportation. Corrections estimates that the policy will reduce its average daily prison population by up to 1,000 inmates annually. Corrections hopes that the federal government will prosecute the individuals who illegally reenter the United States for federal immigration violations, rather than Corrections imposing parole violations on these former inmates. Finally, the deputy described legislation that is being drafted to propose alternative custody options for lower-risk offenders, such as inmates with 12 months or less remaining to serve and medically-infirmed inmates. Under the proposed legislation, these inmates may be eligible to serve their sentences under house arrest with Global Positioning System monitoring.

The Health Care Receiver

Restoring the prison health care delivery system remains a risk to the State. Prison health care reform has been a costly process, exceeding $2.18 billion in fiscal year 2007–08. Although the receiver has recently reported successes, it has also reported challenges. The receiver, through the Inspector General's Office, has instituted annual inspections of medical care delivery to inmates at California's adult prisons, but only 10 of the 33 institutions will be reviewed in fiscal year 2008–09.

Prison health care reform has been a costly process, exceeding $2.18 billion in fiscal year 2007–08 and still remains a risk to the State.

In February 2006 the U.S. District Court for the Northern District of California (District Court) appointed a receiver to oversee the State's prison health care system and ordered the receiver to remain in place until the court was satisfied that the State had the will, capacity, and leadership to maintain a system of providing constitutionally adequate medical health care services to inmates. This action came more than three years after Corrections agreed to meet various conditions related to inmate medical care as part of the *Plata v. Davis* lawsuit. In court documents, the judge stated that the State's prison medical care system was broken beyond repair, that the harm already done to the prison population could not be more grave, and that the threat of future injury and death was virtually guaranteed in the absence of drastic action.

Bringing medical health care to a constitutional level as the District Court ordered has been costly. According to data reported in several governor's budgets and information the receiver provided, costs directly attributable to the delivery of medical care for inmates in California prisons have grown from $907 million in fiscal year 2005–06, when the District Court appointed the receiver, to a high of $2.18 billion in fiscal year 2008–09, and to a projected $1.6 billion in fiscal year 2009–10.[22] However, the receiver's total costs are higher still because the receiver is also responsible for some portion of overhead allocations associated with the provision of medical care, and these overhead allocations are intermingled with those for which Corrections is responsible. Total overhead costs for Corrections range from $210 million in fiscal year 2005–06 to an estimated $431 million in fiscal year 2008–09.

The receiver has a plan to guide its work. In its February 2006 order, the District Court required the receiver to develop a detailed plan of action to restructure the medical health care delivery system and to file status reports summarizing progress in achieving the plan. In January 2008 the District Court ordered the receiver to rework that plan into a more useful leadership tool. The receiver's Turnaround Plan of Action (turnaround plan) was approved by the District Court on June 16, 2008.

Beginning in 2006 the receiver started issuing reports describing its progress in implementing its turnaround plan. In its 10th Tri-Annual Report (10th report) describing its progress on the turnaround plan from September 15, 2008, through January 15, 2009, the receiver reported it had made continued progress toward achieving a constitutionally adequate level of medical care for inmates. Of the 46 discrete actions in its 10th report, the receiver identified two as

22 These figures do not include costs related to the renovation or planning and construction of medical care facilities at Corrections' institutions.

complete, another 23 on schedule for completion by their specified finish date, and 21 being either delayed from the specified finish date or not progressing. Specific successes the receiver reported include achieving a 90 percent staffing level goal for statewide nursing positions and a 90 percent statewide staffing level for physicians being within reach. It further reported its statewide implementation, in November 2008, of an audit tool to formally measure custody performance in providing health care access to patient inmates. This tool is further described later in this section.

However, the receiver identified the State's provision of adequate funding for its projects as a challenge. The turnaround plan calls for the improvement or construction of new administrative and clinical buildings at each of Corrections' 33 prison locations and the construction of seven regional long-term care facilities at existing Corrections' institutions. The receiver indicated that this construction is beyond that required by AB 900, described in an earlier section. Although the receiver noted that planning had progressed on the health facilities for up to 10,000 inmates, it had not begun construction on these facilities. In its 10th report, the receiver indicated that its health care upgrade and facility construction programs were delayed because of the State's refusal to work with the District Court to develop a funding mechanism.

Through the Inspector General's Office, the receiver has begun to measure the effects of its programs. To evaluate and monitor the progress of medical care delivery to inmates at each prison, the receiver requested in 2008 an objective, clinically appropriate, and metric-oriented medical inspection program. The Inspector General's Office designed a tool to evaluate 20 components of medical care delivery, such as chronic care, emergency services, and clinic operations. It assigns a score to each component based on multiple metrics to derive an overall rating of zero to 100 percent. Although the Inspector General's Office provides each institution it evaluates with an overall score, it indicates that it is a legal matter for the District Court to determine the percentage score needed to meet constitutional standards for care. According to a manager within the receiver's office, staff review each medical inspection and work with the institution to respond to described issues.

Latest developments:

The Health Care Receivership (receiver) issued its Eleventh Tri-Annual Report (11th report) on June 1, 2009. Some notable issues the receiver reported on include:

- A dramatic improvement in the cooperative relationship between the receiver and the California Department of Corrections and Rehabilitation (Corrections) during the previous four months, and that it and Corrections had engaged in coordinated planning regarding bed and treatment needs.
- A memorandum of understanding and final settlement between the State and the receiver regarding long-term construction and funding plans was within reach.
- The receiver's momentum had been affected by the State's budget and fiscal crisis, and the continuing disagreement with the State regarding the scope and funding for upgraded and new health care facilities.
- Of the 46 discrete action items discussed in the 11th report, 11 had been completed, 18 were on schedule for completion, and 17 had been delayed or were not progressing.

The receiver indicated that the pending memorandum of understanding between it and Corrections would establish the basis for two new correctional health care facilities—one in Northern California and one in Southern California. These two facilities would provide services to more than 3,300 inmates with medical and/or mental health conditions.

Sources: *Eleventh Tri-Annual Report of the Federal Receiver's Turnaround Plan of Action* issued June 1, 2009, and Health Care Receivership management.

Overall Scores for Medical Inspections Performed Between November 2008 and April 2009

1.	Central California Women's Facility	77.9%
2.	Centinela State Prison	74.4%
3.	Deuel Vocational Institution	72.6%
4.	California Medical Facility	72.4%
5.	R.J. Donovan Correctional Facility	68.0%
6.	California State Prison, Sacramento	65.2%

Sources: Office of the Inspector General medical inspections.

Between November 2008 and April 2009, the Inspector General's Office published medical inspections for six institutions. See the text box for a list of institutions and their scores. In April 2009 the chief assistant inspector general expected that a total of 10 medical inspections would be performed by June 30, 2009. Further, he stated that, once it has secured funding for, staffed, and trained a second inspection team, the Inspector General's Office would be able to perform medical inspections on each institution each year.

In January 2009 the State filed a motion in the District Court to replace the receiver with a special master, arguing that federal law permitted the District Court to appoint a special master but not a receiver. The State asserted that federal law limited a special master's powers to conducting hearings, preparing proposed findings of fact, and simply assisting in the development of remedial plans. However, in establishing the receiver, the State said the District Court transferred absolute authority to control, oversee, supervise, and direct all administrative and operational functions of the medical delivery component of Corrections, in contravention of the letter and intent of federal law. The State further sought to terminate the receiver's construction plans, arguing that the receiver violated federal law by pursuing the wrong goal (creating an extravagant prison health care system instead of one that simply satisfied the Constitution), and did so in an improper manner (failing to proceed in the least intrusive means possible).

The District Court denied the State's motion in March 2009, finding it was not prohibited from appointing a receiver. It further denied the State's motion to terminate the receiver's construction plans, in part finding that the plans were critical to curing constitutional violations and that no other party had presented any viable alternatives that would remedy the violations in a timely manner. The State appealed the District Court's decision to the U.S. Court of Appeals for the Ninth Circuit on April 23, 2009.

Reorganization and Leadership

Corrections continues to face risk in its departmental organization and in maintaining consistent leadership. During 2006 two individuals who served as the secretary of Corrections—the agency's top post—abruptly resigned and a third individual was appointed. In April 2008 the governor appointed the fourth secretary to head Corrections since 2006.

Corrections is not currently measuring its operations against a formal strategic plan. During the first year the current secretary was in office, he directed Corrections to begin developing a new strategic plan to replace the one adopted about two and one-half years before his appointment. During a confirmation hearing on March 25, 2009, the Senate Rules Committee questioned the secretary on his upcoming strategic plan for Corrections. The secretary testified that he thought the strategic plan would be completed by the summer of 2009. He further assured the Senate Rules Committee that the completed plan will have benchmarks to give the Legislature and the public some confidence that the plan's goals will be met. In the interim, Corrections stated it is still working on many of the goals in its old strategic plan. However, it stopped measuring progress against the old plan once it began the process of developing its new strategic plan in the fall of 2008. Until a new plan is complete, Corrections is limited in demonstrating that it is operating in a strategically effective manner.

As we indicated in our initial high-risk report issued in 2007, lack of consistent leadership at the top and in its upper- and mid-level management hampers an organization's ability to succeed. At that time, Corrections' vacancy rate in its top headquarters and warden positions was 34 percent. Our review in March 2009 of its top 83 headquarters and warden positions does not show much improvement—30.1 percent of these positions were either vacant or filled in an acting capacity. However, our review showed that the vacancy rates were not evenly distributed between the headquarters positions and those of the wardens. Although our March 2009 review revealed that Corrections' rate for vacant or acting headquarters positions had improved, 17 of its 33 wardens—in excess of 50 percent—held their positions in an acting capacity.

Corrections' secretary is aware of the organization's leadership issues. In his testimony to the Senate Rules Committee during his confirmation hearing, the secretary noted there has been a leadership void caused by, among other things, its revolving door at the top.

Corrections' secretary noted that there has been a leadership void caused by, among other things, Corrections' revolving door at the top.

Department of Health Care Services and California Department of Public Health

In July 2007 Health Services was split into two departments: Health Care Services and Public Health. The following were legislative goals for the split:

- Health Care Services was to increase its accountability and require program effectiveness for health care purchasing functions of state government.

- Public Health was to increase its accountability and require program effectiveness for the public health functions of state government.
- Public Health was to elevate the visibility and importance of public health issues in the policy arena.

To meet legislative expectations for the split, both departments developed strategic plans in 2008.

To meet these legislative expectations, both departments developed strategic plans in 2008. Further, each department developed implementation plans that identify actions and milestones for achieving their goals and objectives, as well as processes for measuring the overall success of the strategic plans. Although each department is measuring its actions against its respective plan, more time is needed to prove these plans effective. Consequently, these two new departments continue to be on our high-risk list.

An additional expectation the Legislature expressed was for Health Services to implement the split with no overall increase in state funding with the possible exceptions of caseload and inflation adjustments. Through the fiscal year 2007–08 budget process, budgeted resources for the two new departments exceeded Health Services' fiscal year 2006–07 budget. Although management asserted the adjustments were made for reasons independent of the split and would have been made under Health Services, it is nearly impossible to determine which adjustments would have occurred had the split not taken place.

Strategic Plans

According to an associate director, Health Care Services designed a strategic plan to demonstrate its new focus on health care purchasing and the need to demonstrate increased accountability and program effectiveness. It released a strategic plan, consisting of seven main goals and various objectives within each goal, in October 2008. Based on our review, the goals it set seem sound and appear to meet the Legislature's intent. For example, goal four—increase accountability and fiscal integrity—emphasizes program accountability. Health Care Services' fifth goal—ensure viability and availability of safety net services—appears to focus on increasing accountability and ensuring program effectiveness.

Part of a strong strategic planning process is establishing actions needed to meet the goals and a way to measure results against the plan. As a component of its strategic planning process, Health Care Services developed an implementation plan that outlines the actions needed to meet each objective and an internal implementation plan that identifies several milestones for each action and the status of those milestones. Health Care Services is internally measuring the success of its strategic plan on a quarterly basis and, according to an associate director, will release annual updates regarding success. Each of the several quarterly update reports we reviewed focuses on one action and includes the status of the related milestones; it includes any challenges, project delays, costs, and/or savings. This format is designed to allow Health Care Services' management to quickly review the status of a particular action milestone.

Moreover, the associate director asserts that within 10 days of receiving the progress update reports, its practice is for executive management of Health Care Services to meet with the respective division or office chief to discuss the report and determine the next steps. Our review of its internal implementation plan and progress update reports revealed that Health Care Services has been measuring itself against all areas of the strategic plan and that it has met a number of milestones under each of the seven goals. However, because Health Care Services has only been measuring itself against its targeted goals for less than a year, we cannot yet determine if the plan is effective.

Public Health's strategic plan, unveiled in July 2008, contains five major goals with a number of objectives under each. Based on our review of the strategic plan, the goals seem to reasonably align with the legislative expectations of elevating the visibility and importance of public health issues in the policy arena, as well as increasing accountability for public health and ensuring program effectiveness. For example, goal one—increase quality and years of healthy life, reduce disparities and promote health equity—embodies the goals and a subset of objectives identified in the U.S. Department of Health and Human Services' *Healthy People 2010 Report* and seems to fall in line with elevating the visibility and importance of public health issues in the policy arena. Also, goal five—improve effectiveness of business functions—appears to focus on increasing accountability and ensuring program effectiveness. Public Health is a key player in ensuring that the State is prepared for emergencies as noted earlier in this chapter. One of its strategic goals is focused on preparing the State to address public health emergencies and emerging threats.

The primary method Public Health uses for monitoring its strategic plan implementation is its performance measures report. For each objective, Public Health collects data either quarterly or annually and compiles the data into these reports. We found that its second quarter performance measures report, which included cumulative data from July 1, 2008, through December 31, 2008, reasonably measures Public Health's implementation of each objective. Specifically, the performance measures report indicates the target metric and Public Health's progress toward meeting that target. It also contains objective descriptions and responsible-party information to enable management to follow up with staff when necessary. We found that Public Health measures itself against the plan and has reported success in achieving some of its strategic plan objectives. For example, it reported an increased proportion of adults who receive pneumococcal disease vaccinations. Despite this, Public Health still has numerous other targets it has not yet met, and because it has only measured its progress for less than a year, effectiveness of the plan remains unknown.

The secondary method Public Health uses for monitoring its strategic plan implementation is through action plans. Public Health's programs developed internal action plans for each objective to identify processes that would assist the program in meeting the objectives. According to the deputy director for the Health Information and Strategic Planning Division, Public Health's action plans may change over time through lessons learned and best practice development. The deputy director acknowledged that the plans do not serve as a measurement tool but rather provide a way to assess actions taken and a guide to next steps needed to achieve the target objective.

The two new departments' strategic plans have not been in place long enough to determine whether the departments will be successful in reaching their targeted goals.

As new entities, Health Care Services and Public Health face challenges to ensure that they increase accountability and provide effective services. Public Health faces additional challenges to ensure that it elevates the visibility and importance of public health issues in the policy arena. As a result of these challenges, we believe it is important for the two departments to have mature strategic plans to ensure that they meet the expectations set by the Legislature. Although both departments' processes for measuring the success of their strategic plans seem reasonable, the plans have not been in place long enough to determine whether the two new departments will be successful in reaching their targeted goals.

Budget Neutrality

As described previously, the Legislature established the expectation that Health Services implement a split into two departments with no overall increase in state funding, except for possible adjustments prompted by changes to either caseload or inflation. To address the Legislature's expectation, Health Services identified and assigned functions and positions to each new department. It outlined a plan to redirect 57 existing positions to meet the two departments' needs for key management and administrative functions. The deputy director for Health Care Services' administration division told us that although existing overhead support staff could be split between the two departments based upon workload, many overhead support units needed additional positions to maintain their level of support to each department's programs. The deputy director stated that existing positions had to be redirected to meet these needs and that staff sought to minimize the adverse consequences resulting from the redirection.

Health Services also identified certain costs associated with the reorganization and proposed a plan to absorb them within existing budget authority. For example, it identified one-time costs of $900,000 for retrofitting existing space for the new Public Health director's office and for hiring a change management consultant, both of which the deputy director asserts were completely absorbed within Health Services' existing fiscal year 2006–07 budget.

Our review of Health Care Services' and Public Health's budget planning summaries for fiscal year 2007–08 show that, although the departments' budget planning started with figures equal to Health Services' fiscal year 2006–07 authorized budget—also known as a *baseline budget*—the departments adjusted these baseline figures. Some adjustments reflect standard changes such as employee compensation. However, the departments also adjusted the baseline figures for major program and policy changes. For example, Health Care Services proposed a major program change to include the California Discount Prescription Drug Program, which is meant to deliver prescription drugs below retail prices to low-income individuals and families, and eligible seniors. Public Health proposed a major program change for positions and resources to respond to and investigate outbreaks of foodborne illness such as E. coli.

After the two new departments submitted their proposed budgets, additional adjustments occurred as part of the Legislature's actions. In comparing Health Services' budget from the fiscal year 2006–07 budget act with the final fiscal year 2007–08 budget acts for the two departments, we found that the two departments' support (excluding federal funds) increased by $61.9 million, or about 11 percent. According to the deputy director for Health Care Services' administration division, the adjustments made to Health Care Services' and Public Health's budgets were for reasons independent of the split and would have been made under the former Health Services. Notwithstanding the deputy director's comments, it is nearly impossible to determine which budget adjustments would have occurred under Health Services had the split not taken place.

Although adjustments to the two departments' budgets were described as being for reasons independent of the split, it is nearly impossible to determine what adjustments would have occurred had the split not taken place.

Health Services stated in its budget change documents for the split that to achieve budget neutrality, Health Care Services and Public Health would share existing IT equipment, space, and staff. Health Care Services retained the existing IT infrastructure and staff, and Public Health obtained necessary IT services through an interagency agreement with Health Care Services. The budget change proposal stated that costs associated with dividing IT would be absorbed equally over the coming three fiscal years from each department's existing budget authority; each department was to contribute $250,000 per year for a total of $1.5 million to fund IT transition costs.

Nearly two years have passed since the split, and Health Care Services and Public Health have had to reevaluate their original plan to divide shared IT infrastructure and services. According to Public Health's chief information officer (Public Health CIO), in early 2008 the new state CIO informed Public Health of her vision for centralization and consolidation and advised it not to divide its IT infrastructure. The Public Health CIO also asserted that a draft feasibility study report Public Health contracted for revealed that the most cost-effective and beneficial approach would be for it to continue to share IT infrastructure with Health Care Services. However, neither department has finalized a decision.

Public Health does not intend to obtain all of its future IT support through Health Care Services.

According to Public Health, it does not intend to obtain all of its future IT support through Health Care Services. The Public Health CIO told us the department wants to partially follow through on the original plan to divide IT by assuming responsibility for nine of the 19 services it currently receives from Health Care Services, including support for database management, Web services, encryption technology, and mainframe production. According to its CIO, Public Health plans to implement this division no later than the beginning of fiscal year 2010–11, which will mark the end of the current three-year interagency agreement. To ensure the division is budget neutral, Public Health plans to fund any one-time transition costs with part of the $1.5 million that Health Services' original budget change proposal stated each department would set aside to cover the IT transition. After June 30, 2009, only $500,000 of the $1.5 million will remain.

It is important to recognize that whether the IT transition's additional costs stay within the remaining $500,000, or turn out to be considerably more, they will ultimately reduce the amount of funding available for other programs or services. Public Health may need to absorb these costs using its existing budget authority and may need to make decisions to minimize any adverse consequences associated with doing so.

We prepared this report under the authority vested in the California State Auditor by Section 8546.5 of the California Government Code.

Respectfully submitted,

Elaine M. Howle

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State Auditor

Date: June 25, 2009

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For previously published reports presented in chapters 1 and 2, see staff listings within those reports.

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at (916) 445-0255.

Appendix

CONSIDERATIONS FOR DETERMINING HIGH RISK

Introduction

Senate Bill 1437 of the 2003–04 Regular Session of the Legislature (Chapter 251, Statutes of 2004) added Section 8546.5 to the Government Code to provide the Bureau of State Audits (Bureau) with the following authority:

- To establish a high-risk government agency audit program for the purpose of identifying, auditing, and issuing reports on any agency of the State, whether created by the Constitution or otherwise (state agency), that the Bureau identifies as at high risk for the potential of waste, fraud, abuse, or mismanagement or that has major challenges associated with its economy, efficiency, or effectiveness. This includes challenges that cut across programs or management functions at all state agencies or multiple state agencies; we refer to these as statewide issues.

- When identifying state agencies or statewide issues that are at high risk, in addition to reviewing the work of the Bureau, to consult with the Legislative Analyst's Office, the Milton Marks Commission on California State Government Organization and Economy, the Office of the Inspector General, the Department of Finance, and other state agencies with oversight responsibilities.

- To issue audit reports with recommendations for improvements in state agencies or with regard to statewide issues identified as at high risk not less than once every two years.

- To require state agencies identified as at high risk, including state agencies with responsibility for a statewide issue, to periodically report to the Bureau on the status of recommendations for improvement made by the Bureau or other state oversight agencies.

In addition, Section 8546.5 requires the Bureau to notify the Joint Legislative Audit Committee whenever it identifies a state agency or statewide issue as at high risk.

Criteria for Determining if State Agencies and Major Issues the State Faces Merit High-Risk Designations

To determine whether a state agency's performance and accountability challenges are of high risk to the State, we first consider the significance of an agency's mission or functions and the extent to which the agency's management and program function is key to the State's overall performance and accountability. We then determine whether risk is involved and if it stems from one of the following:

- A risk that could be detrimental to the health and safety of Californians.
- The nature of a program could create susceptibility to fraud, waste, and abuse. For example, a program involving payments to claimants for services provided to third parties involves risk due to the difficulty in verifying claims.
- A systemic problem that has created inefficiencies and ineffectiveness.

To identify a high-risk statewide issue we consider the following:

- Is it evident in several state agencies?
- Does it affect the State's total resources?
- Does it stem from some deficiency or challenge that warrants monitoring and attention by the Legislature through the Joint Legislative Audit Committee, the Joint Legislative Budget Committee, other legislative committees, or other legislative action?

For both state agencies and statewide issues, we also consider a number of qualitative and quantitative factors as well as whether or not an agency has taken corrective measures for deficiencies previously identified or whether the State is taking measures to reduce the risk a statewide issue may pose. In all cases, the ultimate determination of high risk is based on the independent and objective judgment of the Bureau's professional staff.

Qualitative and Quantitative Factors

In determining whether a state agency or statewide issue should be identified as at high risk, we consider a number of qualitative and quantitative factors. Although we consider many qualitative factors, in particular we focus on whether the risk could result in significantly impaired service; program failure; significantly reduced efficiency and/or effectiveness; public injury or loss of life; reduced confidence in government; or unauthorized disclosure, manipulation, or misuse of sensitive information.

To the extent possible, we take into account the risk to the State in terms of monetary or other quantitative aspects. We consider that a $1 billion investment by the State for a program would be an indicator of potential material loss. We also look at changes in assets—additions and deletions—as an indicator of potential risk to major agency assets being lost, stolen, or damaged. We further consider risks that revenue sources may not be realized or improper payments may be made. Finally, we alconsider the number of employees each state agency is authorized to hire in determining the magnitude of human capital.

Responsiveness to Recommendations and Corrective Measures

Senate Bill 1452 of the 2005–06 Regular Session of the Legislature (Chapter 452, Statutes of 2006), requires that state agencies provide the Bureau with updates on the implementation of recommendations we have made to them in the form and at intervals prescribed by the Bureau. Moreover, Chapter 452, Statutes of 2006, places additional reporting requirements on state agencies that have not implemented audit recommendations that are over one year old.

The Bureau also receives whistleblower complaints about improper governmental activities under the California Whistleblower Protection Act and regularly issues public reports on substantiated complaints. That act requires state agencies to either take corrective action on substantiated complaints and report to us what action is taken, or if no action is taken, the reason for not doing so.

We consider whether each state agency audited or investigated demonstrated commitment in implementing audit recommendations or taking corrective measures for any substantiated complaints or issues noted in our reports. The final determination on how committed agencies are about making changes to address audit recommendations or taking corrective measures stemming from investigations may include additional follow-up reviews by the Bureau and ultimately is based on our professional judgment.

Ongoing Reporting and Future Audits

Once the Bureau identifies as at high risk a state agency or statewide issue, the Bureau may require the affected agencies to report on the status of recommendations for improvement made by the Bureau or other state oversight agencies. Related to that, the Bureau may require affected agencies to periodically report their efforts to mitigate or resolve the risks identified by the Bureau or other state oversight agencies. In addition, the Bureau may initiate audits and issue audit reports with recommendations for improvement in the affected agencies.

Removal of High-Risk Designations

When we designate agencies or statewide issues as at high risk and place them on our high-risk list, removing the designation takes a demonstrated commitment by the leadership of the state agency or agencies responsible for addressing the risk. The agency or agencies should appoint a person, group, or entity responsible to address the risk, and those responsible must devote sufficient resources to mitigate or resolve it. Further, those responsible must develop detailed and definitive action plans, including, when necessary, plans to seek legislative action. Those plans should define the root cause of the risk, identify cost-effective solutions, and provide a timetable for completion. Moreover, the responsible party must have a process for independently monitoring and measuring the effectiveness of steps taken and for periodic reporting regarding progress.

When legislative and agency actions result in significant progress toward resolving or mitigating a high-risk issue, we will remove the high-risk designation. The agency or agencies must also demonstrate progress in implementing corrective measures. However, we will continue to closely monitor these issues. If risks again arise, we will consider reapplying the high-risk designation. The final determination of whether to remove a high-risk designation will be based on our professional judgment.

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