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

Dear Governor and Legislative Leaders:

This letter report presents the results of a follow-up review the Bureau of State Audits (bureau) conducted concerning information presented to the Legislature by the Department of General Services (General Services) and relevant actions related to recent recommendations that the bureau made to the governor. On March 9, 2011, the bureau submitted 14 recommendations to the governor for ways to reduce government waste, increase revenue, and improve efficiency. Four of the 14 recommendations related to General Services' responsibilities for its fleet and other state vehicles, procurement, and leasing. These recommendations related to issues discussed in certain reports that the bureau previously issued. In a March 23, 2011, oversight hearing (March 2011 hearing) held by the Joint Legislative Audit Committee (audit committee), the state auditor agreed that the bureau would follow up on information presented by General Services related to the recommendations and report back to the audit committee. As part of this review, we also identified the status of certain key recommendations we made in our audit reports on the issues.

Background

The bureau has issued a variety of reports dealing with the topics addressed in our recommendations to the governor. In July 2005 the bureau issued an audit report titled *Department of General Services: Opportunities Exist Within the Office of Fleet Administration to Reduce Costs* (Report 2004-113). Our report concluded that General Services' Office of Fleet Administration's[1] (Fleet) analyses, which indicated that its vehicle rental rates were competitive with those of commercial rental companies, did not fully demonstrate its cost-effectiveness because Fleet lacked assurance that the commercial rates it used in its comparisons were similar to what state agencies actually paid. In addition, we concluded that Fleet did not periodically assess the cost-effectiveness of individual garages, nor did Fleet measure the cost-effectiveness of its repair and maintenance services. We made several recommendations related to how Fleet should assess its cost-effectiveness. For example, we recommended that Fleet compare the actual cost of operating its motor pool to the amount that the State actually pays commercial rental companies. Additionally, we recommended that Fleet examine individual garages to determine whether it was cost-effective to operate them.

In May 2007 the bureau issued a follow-up report titled *Department of General Services: The Office of Fleet Administration Could Do More to Better Analyze the Cost-Effectiveness of Its Garages and Rental Vehicles* (Report 2007-502). Our follow-up review indicated that Fleet

[1] The Office of Fleet Administration is now known as the Office of Fleet and Asset Management.

still had not conducted the analyses based on actual costs that we had recommended in our July 2005 report to ensure Fleet's competitiveness with commercial rental companies. In addition, Fleet was unaware that two of its garages had been operating at a deficit until after our analysis brought the matter to its attention. Further, according to a consultant retained by Fleet, its maintenance and repair shops were marginally productive.

Further, the bureau issued investigative reports that identified concerns about vehicle usage and leasing. In September 2004 we issued *Investigations of Improper Activities by State Employees: January 2004 Through June 2004* (Report I2004-2) in which we reported on an investigation involving Department of Health Services' managers and employees that regularly used state vehicles for their personal use. Additionally in September 2007 we issued *Investigations of Improper Activities by State Employees: February 2007 Through June 2007* (Report I2007-2) in which we reported on an investigation in which the Department of Mental Health (Mental Health) violated provisions of state law that require a state agency to justify its need to purchase vehicles and receive prior approval for the purchase from General Services. In April 2009 we reported on a leasing concern in our report *Investigations of Improper Activities by State Employees: July 2008 Through December 2008* (I2009-1). In that report, we concluded that the Department of Corrections and Rehabilitation (Corrections) and General Services wasted $580,000 in state funds by continuing to lease office space that had not been occupied for more than four years.

Finally, in July 2010 the bureau issued an audit report titled *Department of General Services: It No Longer Strategically Sources Contracts and Has Not Assessed Their Impact on Small Businesses and Disabled Veteran Business Enterprises* (Report 2009-114). The purpose of strategic sourcing was to enter into statewide contracts that leveraged the State's purchasing power to save money on the goods and services purchased most frequently by state agencies. A key issue we reported was that, although General Services had realized at least $160 million in net savings to the State through June 2007 from strategic sourcing contracts it awarded in 2005 and 2006, it had not awarded any new strategically sourced contracts.

The Cost-Effectiveness of the Motor Pool and State Garages Merit Continued Attention

We recommended that the governor direct Fleet to compare the actual cost of operating its motor pool to the amount the State would pay commercial rental companies and consider closing state garages that are not cost-effective. At the March 2011 hearing, the state auditor discussed our July 2005 audit report and May 2007 follow-up review. Our May 2007 report noted that despite capturing the relevant financial data, Fleet was not aware that two of its garages had been operating at a loss. Additionally, the May 2007 report concluded that Fleet had not conducted the analyses we had previously recommended in our July 2005 report to measure its cost-effectiveness by comparing the actual costs to operate the motor pool to the amount that the State would pay using similar vehicles at the rates charged by commercial rental companies. Further, the report referred to a consultant study that concluded Fleet's maintenance management program was not providing competitive services. At the March 2011 hearing, the deputy director that oversees Fleet indicated that it is continually evaluating its motor pool and garage operations, and that it now has very good individual garage information. Additionally, the deputy director discussed a comparison that Fleet performed between the rates it charges for its services and the rates charged by a commercial rental company.

Fleet currently operates four state garages located in Fresno, Los Angeles, Oakland, and Sacramento. Until October 2010 Fleet also operated a garage in San Diego. At that time, it concluded that the location of the San Diego garage was not easily accessible by state employees and therefore was grossly underutilized and not cost-effective. It then opened up a satellite fleet office with nine daily vehicles in downtown San Diego on a trial basis to determine whether the new location is cost-effective. The state garages and the San Diego fleet office offer long-term monthly and short-term daily vehicle rentals to state agencies for employees who are conducting state business. The Fresno, Oakland, and Sacramento garages also offer onsite vehicle preventative maintenance for the vehicles that Fleet rents to state agencies as well as for vehicles owned by other state agencies. The Fresno and Sacramento garages also offer parking for state employees for a fixed monthly rate.

Fleet management states that Fleet has been slowly reducing garage services over time due to declining demand. Management notes that the bulk of the motor pool is now leased monthly to other state agencies. These vehicles are assigned on a long-term basis, and the vehicles' use of the garages has decreased. Fleet has chosen to respond to this decreased level of activity by not filling staff vacancies in several of the state garages. Further, Fleet has experienced a declining demand for its preventative maintenance services. According to Fleet management, as vehicles have become more complicated, the diagnostic products and ongoing training needed to repair them have become cost-prohibitive, and drivers have found it more convenient to take their vehicles for repair to a closer, commercial automotive repair facility. Fleet management noted that it terminated preventative maintenance in its Los Angeles garage in 2007. It further stated that in early May 2011 Fleet discontinued maintenance services in Fresno when its last service technician retired.

In response to our inquiry regarding savings resulting from these actions, Fleet management provided estimated annual savings based on operating expenses from the most recent applicable fiscal year income and expense statements for those operations. Management reported that the closure of the San Diego garage resulted in net savings of $315,000 per year, which reflects the offset of the estimated operating expenses for the satellite office opened in place of the garage. In addition, Fleet management reported savings associated with the elimination of preventative maintenance services for Los Angeles as $279,000 per year and for Fresno as $56,000 per year.

We obtained Fleet's February 2011 cumulative fiscal year-to-date statements, which include income and expenses for each of the state garages including preventative maintenance, and noted that the statements indicated an overall profit of $5.2 million. Further, each garage showed an overall profit. Fleet management indicated that a factor contributing to the level of profit being reported by the garages was that depreciation expense was lower than it would have been had there not been restrictions on purchasing vehicles in recent years. However, in considering the reported profits, it is also important to recognize that the most predominant revenue source for the garages are the monthly rentals, and these vehicles are assigned to state agencies on a long-term basis and are not even housed in the garages. Management acknowledged that if the monthly rentals are excluded, the motor pool and garages are not profitable. In particular, in the February 2011 cumulative year-to-date statement, the preventative maintenance component of the operations reported an overall loss of $1.1 million and all of its maintenance programs are operating at a loss.

Subsequent to our review of the February 2011 income and expense statements, Fleet management indicated that using fiscal year-end statements, which include a full year of activity, would more accurately reflect a true picture of profitability because of lags in expenses and payment of annual costs such as insurance. Thus, we also considered Fleet's June 2010 fiscal year-end statements, the statements for the most recent full year of operations. These statements report an overall profit of more than $4.3 million, with each garage showing a profit, except for Sacramento, which showed a loss of $265,000. In addition, the preventative maintenance component for the fiscal year ending June 2010 reported an overall loss of more than $1.5 million, with all of its maintenance programs operating at a loss.

Fleet management believes that it is important to take parking operations into consideration when determining the profitability of the Sacramento garage. Management stated that the parking revenues from the Sacramento garage, which are maintained in the fund that accounts for revenues from all parking facilities overseen by General Services, generated a profit of about $278,500 for fiscal year 2009–10 and that accordingly the overall profit of the garage was $13,500. To support the $278,500 profit, Fleet provided a summary containing revenues and expenses for each state parking facility, including the Sacramento garage. However, Fleet management acknowledged that although parking revenues are tracked by garage, parking expenses are not. Thus, the expenses considered in determining the profit for the Sacramento garage's parking operation and reflected in the summary were based on an allocation of overall parking expenses, rather than actual parking expenses associated with the garage. Further, Fleet management states that the $278,500 in profit from the Sacramento garage's parking operations has been directed to help pay for an annual bond payment totaling approximately $1 million that the entire parking fund is obligated to pay. Management's perspective is that regardless of the ultimate use of income earned from operations, including parking, the Sacramento garage's functions and activities resulted in an overall profit of $13,500, which it believes to be of primary concern in any decisions related to reviewing its financial status. Nevertheless, we note that the $278,500 in reported parking profit is not available to offset the $265,000 loss that resulted from the operations of the Sacramento garage other than parking.

During our review, Fleet management stated that it has streamlined operations and made changes when it has been cost-effective to do so and that it continues to evaluate the services and cost-effectiveness of all of its operations. We note that there are certain constraints that would need to be factored into any future consideration of closing state garages. For example, General Services' lease for the Los Angeles garage facility runs through 2026 and does not allow for early termination until December 2016. Thus, Fleet is committed to paying for the lease through December 2016, even if it closed the garage at an earlier date. The rates escalate throughout the life of the lease. The rates under the lease currently total $575,000 a year and in December 2013 increase to more than $630,000 until the early termination date. Fixed costs such as these would need to be considered when evaluating whether closing the state garages makes economic sense.

Shortly before this report was issued, General Services announced its plans to eliminate all but one of the state garages. On June 15, 2011—during the period in which General Services was reviewing our draft report—it issued a press release stating that it will close its Fresno, Los Angeles, and Oakland garages and its San Diego fleet office. Additionally, although the Sacramento garage will remain open, General Services plans to eliminate preventative maintenance in that garage within one year. In the press release, General Services' director commented that the data showed that the garages are no longer cost-beneficial for taxpayers in supporting state government. According to the press release, General Services will begin the process of closing the facilities later this year and expects to save more than $2 million annually because of the closures. Because this announcement was made so late in our report process, we are unable to provide any information regarding General Services' savings estimate.

In addition to the profitability of the state garages, we also considered Fleet's efforts to ensure that it was providing competitive services. At the March 2011 hearing, the deputy director that oversees Fleet referred to a comparative analysis of Fleet's long-term rental rates with the rates charged by the commercial rental companies with which it has contracted. As of April 2011, according to information provided by Fleet, long-term rentals comprised 92 percent of its motor pool. We reviewed the comparison, which indicated that Fleet's rates for four classes of vehicles are substantially less than the contract rates in place at the time of the hearing. In addition, the comparison indicated that Fleet's rates are less than the rates included in a new contract, for which General Services was able to negotiate much lower rates, that was pending approval at the time of the hearing. The comparison to the new contract indicated that Fleet's rates ranged from 15 percent lower for a full-size rental to 46 percent lower for a minivan. We verified that the rates included in the comparison agree to Fleet's published rates for long-term rentals. On May 20, 2011, the new contract was approved. We reviewed the new contract and noted that the contract rate includes unlimited mileage while the rate used by Fleet in its comparison was for vehicles driven at least 12,000 miles but less than 24,000 miles per year. Because Fleet's rates vary based on the mileage driven, this comparison would yield different conclusions depending on the number of miles driven. For example, Fleet's rates for vehicles driven at least 24,000 miles but less than 36,000 miles for two of the four classes of vehicles are a little more than 2 percent higher than the rates under the new contract.

Although rate comparisons may provide some useful information, we note that Fleet still is not conducting an analysis to measure the cost-effectiveness of its motor pool as we recommended in our 2005 report. Specifically, we recommended that Fleet compare the actual cost of operating its motor pool to the amount commercial rental companies would actually charge state agencies. Subsequent to our recommendation, a consultant hired by Fleet performed a cost-effectiveness analysis in 2006. We noted in our 2007 follow-up report that the analysis performed was an improvement over prior analyses because it attempted to compare actual costs of renting a specific type of vehicle. However, we also noted that the consultant reported certain limitations in its calculations that were cause for concern. For example, although the consultant's report stated that its analysis was limited to one vehicle type—the compact sedan—the data used by the consultant for its analysis did not specify the vehicle type. Therefore, the consultant could not be sure the transactions used for its calculations only represented those for compact sedans. The deputy director acknowledged that Fleet's cost-effectiveness comparisons since the consultant's analysis in 2006 have focused on rate comparisons.

Finally, we followed up on a concern regarding the competitiveness of maintenance and repair services that we reported in our 2007 follow-up review and presented at the March 2011 hearing. In the 2007 report we pointed out that the consultant who performed a study of Fleet's operations in 2006 concluded that Fleet's maintenance management program, which is responsible for approving maintenance for all state vehicles, was not competitive in terms of costs and service levels. The consultant concluded that Fleet's estimated annual maintenance and repair costs were $312 higher per vehicle than the costs of the largest U.S. fleet management company it chose for comparison. According to the deputy director that oversees Fleet, the consultant's conclusions are still valid and no further analysis has been performed. When we asked what was being done to address the concern, we were informed that General Services intends to issue a request for proposal for state fleet maintenance services in fall 2011. The purpose is to test the private sector market in an effort to establish a comprehensive statewide contract for fleet maintenance services that would provide both competitive pricing and value.

General Services Has Initiated a Process to Carry Out the Governor's Executive Order for State Agencies to Relinquish All Nonessential or Cost-Inefficient Vehicles and Equipment

We recommended that the governor direct all state agencies that have issued state cars to employees to justify the business need and evaluate whether issuing cars to state employees is cost-effective. At the March 2011 hearing, the state auditor reported that use of state vehicles is a frequent subject of allegations received by the bureau's investigative division under the Whistleblower Protection Act and referred to two investigative reports that the bureau issued in September 2004 and September 2007. In September 2004 the bureau concluded that managers and employees at the Department of Health Services' Medical Review Branch Office in Southern California regularly used state vehicles for their personal use. Nine employees, including two managers, used state vehicles to commute between their homes and the office in violation of state laws and regulations. In September 2007 the bureau concluded that Mental Health violated provisions of state law that require a state agency to justify its need to purchase vehicles and receive prior approval for the purchase from General Services. Mental Health purchased two Crown Victoria Police Interceptors for law enforcement purposes but instead chose to use them for non-law enforcement purposes, including commuting.

At the March 2011 hearing, the deputy director that oversees Fleet indicated that General Services is conducting a top-to-bottom analysis of state agencies' assets subject to the January 2011 Executive Order B-2-11 (executive order). In addition, the deputy director indicated that vehicle home storage permits are receiving special scrutiny as part of that analysis.

General Services' responsibilities under the executive order build upon its responsibilities under California Government Code, Section 13332.09, which mandates General Services to investigate and establish the need for acquisition or replacement of motor vehicles for state agencies. The executive order requires, among other things, that each state agency secretary under the governor's authority conduct an analysis to determine the purpose, necessity, and cost-effectiveness of vehicles and equipment in their fleet. The executive order requires that the analysis result in a plan to relinquish nonessential and cost-inefficient vehicles and equipment. The executive order calls for General Services to assist in developing the plans, and the plans are subject to General Services' approval. General Services is also required to assist state agencies in relinquishing the vehicles and equipment once the plans are approved and to report to the Department of Finance on the numbers of both relinquished. State agencies are required to relinquish the vehicles and equipment, within 120 days of their plans being approved, by selling them or transferring them to other agencies where there is a demonstrated need. Additionally, the executive order required the head of each state agency to immediately review their organizations' vehicle home storage permits, withdraw those that are nonessential or cost-ineffective, and report on the results of its review by March 1, 2011. Unlike the previous July 2009 executive order S-14-09, which required each state agency to reduce the overall size of its fleet by at least 15 percent and vehicle storage permits by at least 20 percent, the recent executive order does not require that a specific percentage reduction be achieved. Instead, the extent of reductions may vary by state agency based upon the analysis performed.

We followed up on the assertions made at the March 2011 hearing to determine how General Services plans to implement the executive order and when implementation is expected to be completed. In February 2011 General Services' Fleet entered into a contract with Mercury Associates, Inc. (Mercury), to assist in the development of a systematic process for reviewing California's fleet, not only to fulfill the executive order in a timely manner, but also to systematically review the fleet on a routine basis. The process, known as *vehicle allocation methodology*, is a method to establish and control fleet size and composition. According to the time line provided in the contract that we reviewed in early May 2011, it is expected that Mercury will deliver to Fleet and the Department of Finance by June 2011 an initial analysis, which is to include a description of findings for each state agency and preliminary recommended actions for individual vehicles. After additional analysis and follow-up interviews, Mercury is scheduled to deliver a final analysis in August 2011. The time line provided by Fleet during our review indicates that the actual reductions that result from the analysis are to be complete by December 2011. The contract also requires Mercury to provide training and knowledge transfer to Fleet staff.

To determine what has been accomplished to implement the executive order as of the time of our review, we reviewed General Services' implementation plan provided by Fleet. The implementation plan consists of eight phases, as shown in the text box. During a meeting in early May 2011, Fleet management and staff indicated that phase three of the plan, which is initial data analysis, was nearly complete. We reviewed various documents that Fleet provided as support for its reported progress. At that time, Fleet and Mercury were just starting to launch phase four of the plan. In this phase, state agencies will be surveyed regarding the functionality of specific fleet assets and critical business needs. Through an interagency agreement with General Services, the Department of Finance, Office of State Audits and Evaluations (Finance), is to validate information used to comply with the executive order. On a sample basis, Finance will validate information provided by state agencies for vehicle home storage permits, review vehicle utilization data for accuracy, and, upon request, review other items designated as high risk by General Services.

Eight-Phase Plan for Implementing Executive Order B-2-11

1. Data collection.
2. Vehicle home storage permit report.
3. Initial data analysis.
4. Survey state agencies.
5. Vehicle allocation methodology analysis feedback.
6. The Department of General Services (General Services) sends action plans to state agencies.
7. State agencies finalize, certify, and submit fleet reduction plans to General Services for approval.
8. Fleet reduction/disposal.

Source: General Services' Implementation Guide for Executive Order B-2-11.

General Services Has Improved Certain Leasing Processes and Achieved Savings, but Opportunities Exist for Increased Use of Occupancy Data

We recommended that the governor direct state agencies to review any leases of real property to determine whether that property is unoccupied or underoccupied. Our recommendation noted that General Services should terminate the lease as soon as legally possible if space leased is unoccupied. If space leased is underoccupied, General Services should renegotiate the lease so that it only covers the space that is occupied. At the March 2011 hearing, the state auditor discussed an April 2009 investigative report that the bureau issued that supported this recommendation. In that report, the bureau concluded that Corrections and General Services wasted $580,000 in state funds by continuing to lease 5,900 square feet of office space that Corrections had not occupied for more than four years.

At the March 2011 hearing, a branch chief within General Services' Real Estate Services Division (Real Estate) indicated that the Corrections issue identified in the bureau's report prompted General Services to immediately make improvements to its processes. In addition, the branch chief asserted that General Services had renegotiated some of its leases saving the State about $112 million over the term of the new leases and that it had increased lease revenue to more than $16 million per year from $10 million per year.

When we followed up on the process improvements mentioned at the March 2011 hearing, General Services pointed to three policies that it issued in response to the bureau's April 2009 investigative report. In May 2009 General Services issued an "escalation process" policy that addressed the need for its staff to promptly resolve with its stakeholders disputes that have the potential to materially change the scope or direction of a project. The policy included provisions to escalate the matter to upper management if staff could not readily resolve conflicts. General Services believed that the new policy would assist in promptly resolving the types of conflicts that occurred during the Corrections project that was discussed in the April 2009 investigative report. Additionally, General Services issued a policy in May 2009 to ensure more interaction between managers and staff, particularly on projects that were behind schedule or over budget, such as was the case on the Corrections project. The policy requires managers to meet biweekly with project staff on problematic projects. Finally, in June 2009 General Services implemented a policy to establish a time line goal for its "project initiation" process. General Services noted that the policy would assist in preventing lengthy delays in processing space action requests, acknowledging that such delays apparently occurred during the Corrections project.

We also followed up on the branch chief's assertion at the March 2011 hearing that General Services saved the State about $112 million by renegotiating some of the State's leases and found that it was reasonable based on a review of a sample of documents supporting this amount. According to an assistant chief within Real Estate, General Services initiated a new process beginning in March 2009 to identify leases that were in or nearing their "soft term"[2] and had potential to reduce their rent. The assistant chief commented that General Services met with 11 of its major client agencies who either occupied a large number of leased spaces or occupied one or more large contiguous spaces under lease. During the meetings, agency management and General Services mutually agreed upon leases with potential for renegotiation and confirmed each agency's future space needs. The assistant chief stated that General Services also reviewed the remaining lease portfolio to identify any other lease payments that were over current market rents. Concurrently, General Services notified landlords who owned properties that involved state leases of the opportunity to reduce rents in exchange for an extension of the firm term. According to the assistant chief, where an agreement was achievable, General Services renegotiated a less expensive lease with the existing landlord or in some cases negotiated a lease at another location with lower rent. General Services also negotiated new leases where there was an opportunity to reduce the amount of leased space. If a state agency no longer needed the space at all, General Services terminated the lease.

General Services generally calculated savings for instances in which there were new leases by determining the difference between the monthly rates charged when the old lease was replaced with the new lease over the duration of its term. The assistant chief noted that the rates for the old lease were adjusted by an annual increase of 2.5 percent if the lease called for rents to increase consistent with the consumer price index. In the case of lease terminations where no new lease was acquired, the savings were calculated using the monthly rate charged when the space was vacated for the remainder of the terminated lease's term.

As of May 2011, based on documentation provided by General Services, it has generated savings in excess of $113 million. We reviewed the tracking document and related support for 12 of the largest renegotiated leases amounting to more than $60 million (53 percent) of the total savings to the State and noted errors for three leases. However, the only errors we noted were for savings understatements.

2 Soft term is the portion of the total term of the lease where the State can unilaterally terminate its lease commitment without penalty. During the firm term portion, if the State terminates the lease, the State is liable for the total amount of the remaining firm term lease payments.

For one lease, the leasing agent did not capture all of the applicable lease savings, resulting in an understatement of savings over the term of the lease of nearly $450,000. Additionally, we found that one lease representing more than $1.6 million in savings resulting from the termination of a lease was omitted entirely. For a third lease, the leasing agent populated cells with incorrect amounts that understated savings; however, the understatements totaled less than $630. Thus, although our review indicates that the savings that General Services achieved appears to be what the branch chief mentioned at the hearing, it also indicates a need for an increased focus on controls on the part of General Services to ensure that all savings attributable to renegotiated and terminated leases are accurately calculated and included in its tracking document.

We also followed up on the assertion made at the March 2011 hearing by the branch chief that lease revenue has increased to $16 million annually. In May 2011 we obtained a listing provided by General Services supporting its assertion that currently $16 million per year is generated by lease revenue. We reviewed six leases: three between General Services and a third party (lessee) and three between state agencies other than General Services and a lessee. We noted two different types of lease agreements: one type allowed the lessee to use state land or facilities in exchange for rent payments while a second type allowed the lessee to provide services in lieu of rent payments. A section chief indicated that in the absence of arrangements like the latter the State would generally incur expenditures now paid for by a lessee. Thus, our review of the six agreements indicates that the $16 million not only represents revenue but can also reflect savings from cost-avoidance of expenditures that state agencies would otherwise expect to pay.

However, we noted a condition that leads us to believe that the $16 million is significantly overstated. During our review of two of the six leases, we noted that the terms of the leases as stated on the agreements appear to have expired. We contacted representatives of the two state agencies responsible for the leases who confirmed that the leases had in fact expired. One of the leases, which accounted for $3.7 million of the reported $16 million in annual lease revenue, expired in 2008 and has not been renewed. The second lease, which accounted for $600,000 annually, expired in 2006. According to agency staff, a new lease for the same property in the amount of $375,000 per year, was initiated in 2007 but expired in July 2010 and has not been renewed. We noted that the $375,000 was also on General Services' listing supporting the $16 million. Therefore, for just the leases we reviewed, lease revenue is overstated by almost $4.7 million per year. The section chief at General Services was not previously aware of the problem and indicated that leases were assumed to be active until the state agency responsible for the lease notified General Services of a change.

Finally, we considered the extent to which ongoing processes administered by General Services provide information on which properties leased by the State are unoccupied or underoccupied. A May 2011 inventory listing we obtained indicates that General Services oversees more than 1,260 leases of general purpose and field office space, comprising 15.8 million square feet. The listing shows that 55 (4 percent) of the leases are for spaces that are 50,000 square feet or more. The 55 leases represent about 5.4 million square feet, of which 4.7 million square feet is in the Sacramento region. A supervisor for its Asset Management Branch (branch supervisor) states that General Services' practice is to annually conduct space utilization surveys for leases of 50,000 square feet or more in the Sacramento region.

We noted two types of surveys being used for leased space. One type of survey involves General Services' personnel conducting physical reviews of office building leases, while the second survey type involves self-reporting by certain state agencies, which General Services uses in place of its own physical review. During the reviews, General Services' personnel or the self-reporting agency make note of the total number of workstations as well as the number of workstations not assigned to a staff person at that time, which provides a means to determine utilization. However, no regular reviews are being performed for leased space under 50,000 square feet anywhere in the State unless, according to the branch supervisor, circumstances warrant the review. An example of such a circumstance is when another state agency submits a space request.

We reviewed a sample of 15 surveys conducted in the Sacramento region during 2010 and noted that the surveys identified a large amount of vacant space. Specifically, the 15 surveys we reviewed identified about 12,600 workstations of which about 2,600 were found to be vacant. According to the branch supervisor, unassigned workstations are usually interspersed among other workstations throughout the floor and building and are not contiguous. Further, the branch supervisor indicated that survey information is entered into a survey database, which is a separate component of the Statewide Property Inventory system (inventory system). Once survey data is entered into the survey database, the information remains unchanged and is used for portfolio management purposes. We note that surveys measure a point in time and thus may not reflect future space needs. Further, they do not indicate the extent to which underutilized space is contiguous. Nevertheless, the surveys provide a starting point for identifying space that is no longer needed.

The branch supervisor stated that prior years' experience has shown that the information gleaned from annual surveys of smaller office spaces does not justify the required staff time and expense. Additionally, the branch supervisor indicated that a small number of properties located outside the Sacramento region measuring 50,000 square feet or greater are periodically reviewed, depending on location and available staff resources. The last comprehensive physical review focusing primarily on leased spaces in the southern part of the State occurred in 2008. General Services' records indicate that nearly 170 leases were reviewed totaling more than 2.4 million square feet, and all but six leases were less than 50,000 square feet. According to the branch supervisor, the last comprehensive physical review was a major undertaking requiring significant staff resources. The branch supervisor stated that the expenditure of staff time to conduct additional annual surveys would impact their ability to perform their core portfolio management responsibilities; therefore, General Services has determined that it is more prudent to target specific locations and leases for future surveys based on state office space activity in the area. However, General Services' records indicate that properties less than 50,000 square feet represent nearly two-thirds of the square footage of leases that it oversees. Thus, although a cost-effective method of surveying smaller leases would need to be implemented, such as sampling them on a rotational basis, we believe that additional opportunities exist to identify underutilized leased space and leases that potentially could be renegotiated for a reduced amount of space.

In addition to the annual survey process previously mentioned, another existing process could provide additional space utilization information. State law requires General Services to maintain a complete and accurate statewide inventory of all real property held by the State. In addition, the law requires the head of each agency to annually certify that certain information pertaining to real property it utilizes has been reported to General Services. The information reported by each state agency is maintained in the State's inventory system, which is administered by General Services. Although current requirements include reporting whether property is fully or partially utilized, state agencies are not required to include specific information, such as the number of occupied and unoccupied workstations. This information could reflect property that the State leases as well as owns. Therefore, a potential opportunity exists to augment the information contained in the existing inventory system to provide occupancy data to determine space utilization statewide. However, although we believe such an idea merits consideration, we realize that an assessment to determine the costs and benefits is warranted beforehand.

Continued Focus Is Warranted to Ensure That the State Is Leveraging Its Purchasing Power to the Extent Possible

We recommended that the governor create a task force comprised of representatives from various state agencies' procurement staff to discuss purchasing patterns and needs, and consider applying various techniques and best practices throughout the State to maximize savings to the State for future purchases. The bureau has identified problems with procurement practices involving various state agencies in numerous reports we have issued, including information technology, prescription drugs, medical supplies, and other goods. At the March 2011 hearing, the state auditor highlighted our July 2010 audit report on General Services' administration of strategically sourced contracts (July 2010 report). In that report, we stated that General Services had awarded 33 statewide strategically sourced contracts for 10 categories of goods between February 2005 and July 2006. A key issue we reported was that, although General Services had realized at least $160 million in net savings to the State through June 2007 from these contracts and incurred costs to train staff, create a specialized unit, and develop written procedures on strategic sourcing, it had not awarded any new strategically sourced contracts. Moreover, even though the consultant hired in 2004 had identified 20 other categories of goods and services as candidates for strategic sourcing, General Services did not award any new strategically sourced contracts. We recommended that General Services conduct its planned review of these categories to determine if there are further opportunities to achieve savings and that it should work with state agencies to identify detailed purchases for categories that it identifies as viable opportunities.

Our standard practice is to have state agencies update us on the status of recommendations at three scheduled times during the first year after a report is released. If any recommendations are not implemented after one year, they are required to report at one-year intervals. General Services has provided two status updates on our July 2010 report, with the latest update provided in December 2010. In March 2011 we included that information in our annual report to the Legislature on the status of recommendations to state agencies. We reported that General Services completed its review of the consultant-recommended categories that it did not strategically source and concluded that none of the categories warranted additional strategic sourcing contracting efforts. General Services noted that its review confirmed that it used other traditional acquisition techniques to acquire those goods or services that accomplished the same goal as strategic sourcing. It noted that for the remaining categories, such as architectural and engineering services, electricity, and leased real property, the review determined that the categories were of such a broad nature that strategic sourcing techniques could not be applied. In response to our request for documentation of the analysis performed that resulted in its conclusions, General Services provided a document of about three pages. The document commented on the results of each of the categories for which it or others conducted traditional (nonstrategic sourcing) acquisition methods. Additionally, General Services described the factors that it believes prevent strategic sourcing for other categories. For many of the categories for which it reported traditional acquisition methods were used, General Services either indicated that savings would be measured by individual contract or that savings were not measured. The fact that General Services' review was unable to report aggregate savings information for these categories underscores the need for actual savings on future purchases to be tracked in such a way that they can be compared against expected savings.

In response to our recommendation that it work with state agencies to identify detailed purchases for categories that it identifies as viable opportunities, General Services indicated that it periodically reviews databases for items that may indicate a strategic sourcing opportunity. It stated that, in consultation with its customers, it uses available data on purchasing patterns to identify if strategic sourcing or another procurement vehicle should be used. General Services believes that these steps are sufficient to allow it to obtain comprehensive and accurate data on the specific items that state agencies are purchasing that are of a volume that warrant an opportunity for strategic sourcing. General Services stated that it goes through an extensive search for purchasing data using all available sources and that it requests copies of purchase orders from state agencies to obtain more detailed purchasing data. However, in our report to the Legislature, we noted that it was unclear to what extent General Services implemented new procedures since the audit, nor was it able to provide, within the time frames needed for our report, information that would allow us to fully substantiate the actions it reported taking. General Services will be addressing this recommendation further as part of its one-year status update due in July 2011.

Strategic sourcing is just one acquisition technique that General Services has used in the past to award statewide contracts that state agencies can use to purchase goods. At the March 2011 hearing, the deputy director who oversees General Services' Procurement Division addressed statewide contracts in general and commented that typically the State achieved a 10 percent to 15 percent savings rate. The deputy director referred to the most recent reporting period as of January 2011 that indicated a 14 percent savings rate for statewide contracts.

We requested the report supporting the 14 percent savings rate described at the hearing. General Services provided us a report reflecting cumulative contract savings of 14.1 percent from August 2008 through February 2011. The report was generated from the Compliance and Savings Administration (CASA) system. In our July 2010 audit report, we discussed the implementation of the CASA system in 2008 and its use by General Services as a tool to help identify contractors' compliance with pricing terms. Another use of the system is to track savings. We obtained an understanding of the calculated savings rate. The CASA system calculates a savings rate by comparing historical prices to current prices according to contract. Historical prices are determined using several methods. In cases where a like item had been previously reported in the CASA system, the historical price is generally calculated using the historical discount rate against the current list price, while items with no historical data are reported at the current list price. A third method uses an estimated historical price determined by staff using a combination of historical information and institutional knowledge. Generally, current prices are determined by contract discount rates based on list prices or a fixed price. However, only contracts that report activity and a savings for the reporting period are included in the calculation of savings.

When we met with General Services' staff to review some of the support for the report we were provided, we noted a problem that affected the calculation of certain savings. Specifically, we noted that in certain situations the contractors had entered information into the CASA system through a user template loaded into the system, which caused savings to be calculated using the wrong line items, resulting in an overstatement of savings. It appeared as though the issue was widespread and savings could be significantly overstated. We subsequently notified the deputy director of our concerns, and he told us he asked staff to review the concerns we raised as well as examine other contracts in the system.

After staff had performed their analysis, the deputy director responded to us, stating that the report we were initially provided was not for the correct reporting period. The deputy director acknowledged that our observations were accurate regarding the savings data in the report we were provided. He also noted that errors were not uncommon in 2009 because the CASA tool was new to both General Services' staff and the contractors. The deputy director provided us a new report—for the period February 2010 through January 2011—that indicated a savings rate of 14.9 percent. However, he stated that General Services' staff identified reporting problems that reduced the savings rate to 13.4 percent. According to the deputy director, staff concluded after an in-depth analysis that a number of the contracts included in the report contained errors attributable to contractor reporting inaccuracies. When we subsequently met with General Services' staff to review some of the support for their analysis, we noted numerous errors had caused the savings rate to be overstated. The deputy director indicated that steps are continually taken to mitigate errors, including providing training for contractors and General Services' contract administrators. Additionally, the Procurement Division staff who work with the CASA system have implemented some additional validation activities. Nevertheless, the staff's discovery of recent inaccuracies in response to our review indicates that ensuring the accuracy of data in the CASA system needs to be a continuing area of focus for General Services.

We reported a concern about controls over the data being used in the CASA system in our July 2010 report, when we reported on its use as a tool to identify contractors' compliance with pricing terms. We reported that the CASA system reflects usage data reported by contractors, and General Services did not have a process to ensure the accuracy of the data. In its December 2010 status update on our recommendation, General Services indicated that it had not yet implemented procedures to ensure the validity of the contractors' usage reporting but that it planned to do so. General Services reported that as part of its Contract Management Plan (management plan) process, procedures would be implemented to work with state agencies to confirm the accuracy of contractor-reported pricing and to ensure the validity of the contractor's usage reporting. Additionally, the management plan was to include steps to reconcile purchasing agency documents such as purchase orders and invoices to the information contained in the usage reports. We expect to learn more about the status of such efforts when General Services addresses this issue in its one-year status update due in July 2011.

Conclusion

This review focused on information presented to the Legislature by General Services and relevant actions related to four recommendations that we made to the governor in March 2011. We continue to believe that these recommendations merit consideration as state leaders work toward the goal of helping California become more fiscally sound. During our review, we identified some General Services' efforts and existing processes that should be considered as future actions are taken on our recommendations. However, in some areas we also noted conditions that indicate a need for an increased focus on controls to ensure that accurate information is being produced. Accurate information will be critical as state leaders make decisions regarding how to make California government more efficient.

We conducted this review under the authority vested in the California State Auditor by section 8543 et seq. of the California Government Code. We limited our review to those areas specified in the letter report.

Respectfully submitted,

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