

# CALIFORNIA STATE AUDITOR

Bureau of State Audits

## High Risk

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



August 2011 Report 2011-601

HIGH RISK

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# CALIFORNIA STATE AUDITOR

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August 18, 2011

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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:

As authorized by Chapter 251, Statutes of 2004, the California State Auditor presents this audit report assessing high-risk issues the State and selected 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 the California State Teachers' Retirement System's (CalSTRS) Defined Benefit Program to the high-risk list. Contribution rates for teachers and administrators, which can only be changed through legislation, have not changed in decades and are currently not sufficient to ensure the payment of all promised future benefits. Currently the Defined Benefit Program is funded at 71 percent, well below the 80 percent considered necessary for a sound pension plan. Unless the State takes steps, such as raising the contribution rates of CalSTRS members and their employers, it may be responsible for providing the necessary funding using taxpayer money.

We believe that the State continues to face eight other significant high-risk issues: addressing the budget deficit, funding retiree health benefits, ensuring timely expenditure of the American Recovery and Reinvestment Act of 2009 funds, upgrading and expanding the State's infrastructure, ensuring a stable supply of electricity, effectively managing the State's workforce, strengthening emergency preparedness, and providing effective oversight of the State's information technology projects. We further believe that three state agencies continue to meet our criteria for high risk as they face challenges in their day-to-day operations: the California Department of Corrections and Rehabilitation, the California Department of Health Care Services, and the 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, CPA  
State Auditor

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## Summary

### Results in Brief

Providing leadership, programs, and critical services to the people of California is a complex endeavor that encompasses the use of significant resources and is accompanied by inherent risks. A process for identifying and addressing the high-risk issues facing the State can help focus the State's resources on improving service delivery and contribute to enhanced efficiency and effectiveness. 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 in May 2007 (Report 2006-601), and we updated those issues and identified new issues in June 2009 (Report 2008-601). Our current review found that most of the issues we identified in 2009 as posing a high risk to the State continue to be a high risk; we also identified additional issues or departments as being at high risk.

The ongoing budget deficits remain on our list of issues that pose a high risk to the State. Our current review found that the State's budget condition remains unchanged. Specifically, the State has not yet implemented effective strategies for achieving a balanced budget. Instead, many of its proposed solutions to budget deficits push the problem into the future. For example, legislation enacted in 2008 accelerated revenue by limiting the amount of tax credits corporations could use to reduce their tax liability but allowed those unused credits to be carried forward to a future year and therefore reduced future revenues. Moreover, a number of factors make it difficult for lawmakers to effectively address the ongoing budget problem. For example, population segments that are dependent on some of the State's most significant programs continue to increase at rates greater than the increase in the general population. Additionally, voter-approved Proposition 22 prohibits the State's General Fund from borrowing fuel excise tax revenues, which reduces the resources available to cover cash deficits and increases the potential for external borrowing.

We have added the funding of the Defined Benefit Program of the California State Teachers' Retirement System (CalSTRS) as a new high-risk issue. These retirement benefits provide an incentive for teachers to make teaching a career. CalSTRS sets aside funds collected as a percentage of teachers' and administrators' salaries each year to pay future pension obligations. However, the laws governing the contribution rates for CalSTRS members and their employers have not changed in decades. As a result, the Defined Benefit Program is currently funded at 71 percent, well below the 80 percent considered necessary to fund a sound pension program. Additionally, CalSTRS reports that the program's assets

### Report Highlights . . .

*Legislation effective in January 2005 authorizes the State Auditor's Office to develop a risk assessment process. We issued two previous assessments of high-risk issues facing the State. In our current review, we identified an additional issue as being at high risk:*

- » *Funding of the Defined Benefit Program of the California State Teachers' Retirement System (CalSTRS)—laws governing the contribution rates have not changed in decades and the program is currently underfunded.*
- » *We found that most of the issues we identified in 2009 as posing a high risk to the State continue to be a high risk:*
  - *The State's budget condition—ongoing budget deficits remain. The State has not yet implemented effective strategies for achieving a balanced budget.*
  - *Paying for and accounting for retiree health benefits through the pay-as-you-go method is unchanged. The State's estimated liability increased \$12 billion over the previous two years.*
  - *Administration of the billions of federal funds the State received under the American Recovery and Reinvestment Act of 2009—some departments may have to soon forfeit unspent funds.*
  - *Managing the State's prison population and prison institutions.*
  - *Production and delivery of electricity—possible unmet targets to increase the use of renewable electricity sources and the need to replace certain power plants.*

*continued on next page . . .*

- *Maintaining and improving infrastructure.*
- *Managing the State's workforce.*
- *State's level of emergency preparedness.*
- *Information technology oversight.*

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

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

will be depleted in 30 years. Considering that pension obligations can extend beyond 50 years, unless the State takes steps, such as raising the contribution rates for members and their employers, it may be responsible for providing the necessary funding to ensure that CalSTRS' Defined Benefit Program meets its obligations. Consequently, we have designated the funding of CalSTRS' Defined Benefit Program as a high-risk issue.

Likewise, the risk posed by paying and accounting for retiree health benefits through the pay-as-you-go method is unchanged, and therefore this issue remains on our high-risk list. The State continues to cover only the current year's cost of these benefits, without setting aside funds to cover future obligations. As a result, the State's total estimated liability grows each year and as of June 30, 2010, it totaled \$59.9 billion, an increase of nearly \$12 billion over the previous two-year period.

We also found that the various departments we reviewed still face challenges in administering funding received under the American Recovery and Reinvestment Act of 2009 (Recovery Act). Some of the four departments we reviewed are at risk of not being able to spend all Recovery Act funds awarded to them before the spending deadline, and they may have to forfeit any unspent funds. Two of the departments have already had to forfeit a combined total of \$736,303 for two grants that had a spending deadline in 2010. Additionally, although some departments have not finalized their expenditures for some grants for which spending deadlines have passed, significant amounts of Recovery Act funds for these grants may revert to the federal government. In addition to the potential of forfeiting federal funds, the four departments we reviewed continue to demonstrate weaknesses in the internal controls over the federal programs they administer. Our audits in the past two years have uncovered many weaknesses in the administration of various Recovery Act programs by different state departments. A recent report by the U.S. Department of Education's Office of the Inspector General contained similar findings. Further, a report we issued in August 2011 found that of the seven grants with spending deadlines by December 31, 2011, that the Department of Education administers, the expenditures for one raise concerns that all funds will not be spent before the respective deadline. While spending for the remaining six grants appears to be on track for them to be fully spent before their spending deadlines, some subrecipients that received these grants have spent very little and do not appear to be on track to use all of their award amounts.

Managing the State's prison population and prison institutions continues to be a challenge for the California Department of Corrections and Rehabilitation (Corrections). The prison population is currently at 180.2 percent of the prison system's design capacity.

Recently, the U.S. Supreme Court upheld a ruling that requires Corrections to reduce overcrowding to 137.5 percent of design capacity. Consequently, unless the State is able to construct sufficient facilities or identify other means of reducing the prison population by almost 43 percent, it may need to release some prisoners. The State has taken legislative action to reduce the number of prisoners by increasing the dollar thresholds above which property crimes are considered felonies. However, as of June 2011 Corrections still needed to reduce its prison population by 34,000 in two years in order to meet the court's ruling, therefore, these initiatives may prove to be inadequate. Also, the prison health care system is still under federal receivership. The latest report issued by the federal health care receiver (receiver) indicated successes, such as completing many of its 48 discrete actions, as well as challenges to the productivity and implementation of solutions the receiver faces. Further, the California Office of the Inspector General for Corrections found that nearly all prisons were ineffective at ensuring that inmates receive their medications and had poor access to medical providers and services. Consistent with our previous report, Corrections also continues to struggle to maintain consistent leadership and still has a number of vital upper-level positions that are unfilled.

Maintaining and improving infrastructure remains on our list of high-risk issues. The State's infrastructure is under increasing strain due to its age and the State's expanding population. Voters partially funded the State's infrastructure needs when they approved \$42.7 billion in bonds in November 2006. A report the bureau released in May 2011 (Report 2010-117) found that work still needs to be done to ensure bond-funded projects appropriately progress. Additionally, as a result of the current financial condition, the State was not able to issue the \$48.1 billion in bonds needed to fund infrastructure improvements included in the next phase of its strategic growth plan. Further, the State's worsening budget situation has required decision makers to shift focus away from the State's infrastructure needs.

Because a reliable supply of electricity provides a critical foundation for both California's economy and its citizens' standard of living, we added energy production and consumption as a high-risk issue in June 2009. Although the State has made some progress, it still faces uncertainty related to the need to retrofit or replace certain power plants. Currently, plants using once-through cooling, which is an environmentally harmful cooling method, have submitted plans to retrofit those systems to reduce the mortality rate of marine life as required by a state policy. However, these plans have not yet been approved, and the State faces the risk that the plans will not be sufficient and the plants will have to be shut down. Additionally, since our last report California has adopted a more aggressive target for the use of energy from renewable sources, such as wind and solar. However, the State still faces obstacles



related to the construction of the infrastructure needed to transmit electricity from the locations where it is generated to the consumer. Consequently, the State is at risk of not meeting those targets.

Managing the State's workforce is another issue that remains on the bureau's high-risk list. The State continues to face the retirement of a significant number of both leadership and rank-and-file workers with unique perspectives and institutional knowledge critical to running state departments and programs. The percentage of state employees 60 years of age or older in leadership positions who are choosing to retire rose to 35 percent in fiscal year 2009–10, up from 26 percent in fiscal year 2007–08. We project that approximately 12,847, or 42 percent, of the employees in leadership positions as of June 30, 2008, could potentially retire by fiscal year 2014–15. Since our June 2009 high risk update, the State has made progress in streamlining the hiring process through the Human Resources Modernization Project (HR-Mod). However, it is uncertain which efforts initiated by HR-Mod will continue and what effect the governor's recent proposal to merge the Department of Personnel Administration and the State Personnel Board into a single department will have on the State's efforts to maintain the State's workforce. Further, many departments are still in the process of developing or assessing their workforce and succession plans.

The State's level of emergency preparedness remains a high-risk issue. Although there has been progress in this area, the Department of Public Health (Public Health) and the California Emergency Management Agency (CalEMA) still need to address various issues. Specifically, Public Health has established performance measures and deadlines in its strategic plan. However, it has not always achieved those performance measures. For example, it failed to meet its target of increasing the number of local health departments with Strategic National Stockpile ratings of 70 or better, which would mean their performance is acceptable to receive and distribute public health emergency medical assets. Similarly, although CalEMA has made progress on its Metrics Project, which is a resource typing and data gathering project aimed at developing a common structure and nomenclature for the inventorying and assessment of emergency resources and capabilities on a statewide basis, it is not yet complete. Additionally, it did not identify performance measures in its first strategic plan and has not started some activities related to the objectives as planned.

Since our last update, the State has shown improvement related to its oversight of information technology (IT) projects; however, this remains a high-risk issue. The California Technology Agency (Technology Agency) monitors projects to ensure that they remain on schedule and within budget; rejects projects that lack a business case, financial resources, or appropriate technology; and

provides IT infrastructure and shared services. However, although the Technology Agency has strengthened its role in IT project oversight, due to the high cost of state IT projects and the Technology Agency's relatively new project management structure, IT oversight remains an area of high risk.

Finally, we have added the Department of Health Care Services and Public Health to our list as departments that present a high risk to the State. In recent years, the Legislature, because of a variety of concerns, has requested a higher number of audits for these two departments and recent audits have uncovered significant deficiencies in the policies and procedures of both departments that could affect public health. We have also identified a number of recommendations that these departments have not implemented after one year. However, we found that both of these departments have incurred less in administrative costs than the former Department of Health Services would have had the split not occurred. As a result, we no longer believe that spending by the two departments in comparison to that of the former Department of Health Services constitutes a high-risk issue.

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## Introduction

### Background

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 their implementation of the recommendations. 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.

### **The Bureau's Criteria for Determining Whether State Agencies and Major Issues the State Faces Merit High-Risk Designations**

To determine whether a state agency's performance and accountability challenges pose a 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 constitutes one of the following:

- An issue that could be detrimental to the health and safety of Californians.
- A program that could be at risk of 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:

- Whether it is evident in several state agencies.
- Whether it affects the State's total resources.

- Whether it stems 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 measures to correct previously identified deficiencies 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. The Appendix further describes these factors. Additionally, the Appendix outlines the factors we consider in determining whether it is appropriate to remove a statewide issue or agency from our high-risk list.

### Scope and Methodology

California Government Code, Section 8546.5, authorizes the bureau to audit any state agency it identifies as high risk and to issue related audit reports at least once every two years. In May 2007 we issued a report<sup>1</sup> that provided an initial list of high-risk issues, and in June 2009 we issued an update report<sup>2</sup> on the status of those issues and others that had been added.

Subsequent to our May 2007 report, the bureau continued to evaluate issues faced by the State for inclusion on our high-risk list. For select issues on the list, we also performed in-depth reviews to determine whether the risks had been mitigated. As a result, we issued separate reports specific to the following issues: the State's budget condition; other postemployment benefits for retiring state employees; maintaining and improving infrastructure; the administration of federal funding received under the American Recovery and Reinvestment Act of 2009; and the production and delivery of electricity, emergency preparedness, and management of human resources. Each of these reports contains details of our scope and methodology for conducting the particular review. With this 2011 update, we are adding the funding of the California State Teachers' Retirement System to our list of high-risk issues.

<sup>1</sup> *High Risk: The California State Auditor's Initial Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2006-601, May 2007)

<sup>2</sup> *High Risk: The California State Auditor's Updated Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2008-601, June 2009)

To update our analysis of high-risk issues and departments facing risks and challenges, 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.

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## Chapter 1

### IMPROVING THE STATE'S BUDGET CONDITION AND PURSUING SOUND FISCAL POLICY

Various fiscal issues continue to pose a high risk to the State, and one new issue is being added with this report. The State's budget condition remains on the list of high-risk issues because of continued budget deficits and difficulty in resolving budget problems. In addition, we have added the Defined Benefit Program of the California State Teachers' Retirement System (CalSTRS) to the list. The funded status of this program has decreased to 71 percent, jeopardizing the ability of CalSTRS to meet its pension obligations in the future without financial assistance from taxpayers. Similarly, the State continues to face unfunded liabilities related to retiree health benefits; these liabilities have grown by \$12 billion in the last two years alone. Finally, the American Recovery and Reinvestment Act of 2009 (Recovery Act) remains an area of concern. Some state departments we reviewed may have to forfeit Recovery Act funds due to their inability to spend all funds before the deadline, and issues involving the administration of Recovery Act funds make this an area of continued risk.

#### Addressing the Budget Deficit

The Bureau of State Audits (bureau) designated the State's budget condition as a high-risk issue in February 2009.<sup>3</sup> Since that time the State has continued to face large budget deficits. However, it has yet to implement effective solutions for achieving a balanced budget and thus continues to be on our list of high-risk issues.

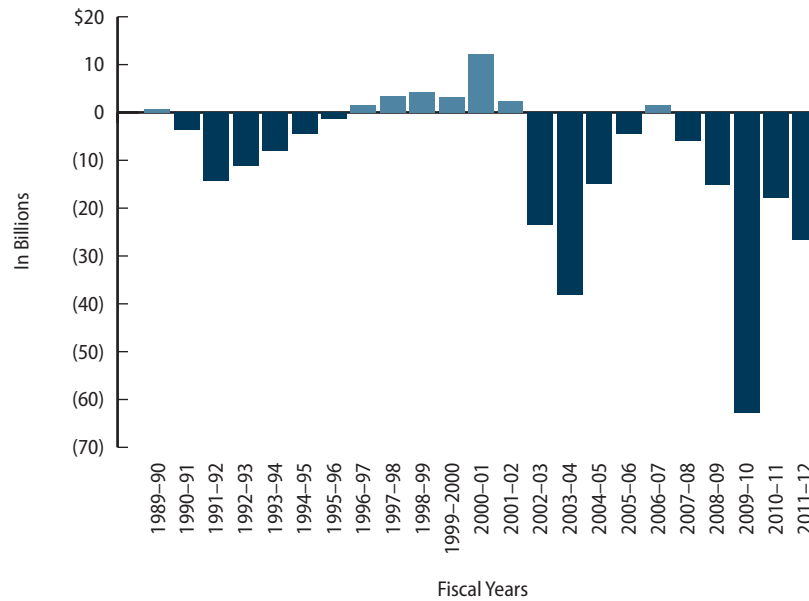
Our current review found that the State's budget condition continues to pose challenges. In fact, in fiscal year 2009–10 the State experienced a \$62.9 billion deficit, the largest in its history. A portion of this deficit was the result of the State not receiving the revenues projected for fiscal year 2008–09. According to the State Controller's Office, the State received only \$85 billion of the \$101 billion in revenue it had anticipated during fiscal year 2008–09. However, the State actually spent approximately \$98 billion during the year, creating a significant shortfall. Because the State had to address this shortfall when developing the fiscal year 2009–10 budget, it faced a larger deficit than it otherwise would have. As Figure 1 on the following page shows, although the

<sup>3</sup> *High Risk: The California State Auditor Has Designated the State Budget as a High-Risk Area* (Report 2008-603, February 2009).



deficit for fiscal year 2010–11 and the projected deficit for fiscal year 2011–12 are not as severe as the deficit for fiscal year 2009–10, they continue to be significant.

**Figure 1**  
Projected General Fund Budget Surpluses and Shortfalls as of the May Revision  
Fiscal Years 1989–90 Through 2011–12



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

Despite the history of continuing deficits, the State has not yet implemented effective strategies for achieving a balanced budget. As shown in Table 1, 17 percent of the solutions to address deficits between fiscal years 2002–03 and 2011–12 increased the State's debt, and another 19 percent involved a combination of shifting money from one fund to another, requiring taxes to be paid earlier than usual, and deferring expenditures for some programs. For example, legislation passed in 2008 accelerated revenue by limiting the amount of tax credits corporations could use each year to reduce their tax liability for the period January 1, 2008 through December 31, 2009. During this period corporations could not use credits to reduce their taxes by more than 50 percent of their tax liabilities, but they could carry over any unused credits to reduce their tax liabilities in subsequent years. Although this solution worked to increase the State's revenues in the short term, it results in reduced revenues in subsequent years.

**Table 1**  
**Types of Solutions Implemented to Reduce Budget Shortfalls**  
**Fiscal Years 2002–03 Through 2011–12**

	FISCAL YEARS									
	2002–03	2003–04	2004–05	2005–06	2007–08	2008–09	2009–10	2010–11	2011–12	OVERALL
<b>Total amount of budget solutions (dollars in billions)*</b>	\$23.64	\$39.40	\$16.10	\$5.85	\$4.93	\$23.97	\$59.60	\$19.30	\$24.20	\$192.79
<b>Percentage by solution type†</b>										
Expenditure reductions	32%	21%	31%	71%	28%	36%	49%	63%	29%	38%
Revenue increases	17	15	15	2	33	17	23	23	37	21
Increased debt‡	13	41	39	15	–	17	4	6	12	17
Fund shifts or transfers	12	10	15	12	26	4	6	5	19	10
Accelerated revenues	19	5	–	–	12	11	4	–	–	6
Expenditure deferrals	7	5	–	–	–	8	–	4	1	3
Federal stimulus funds	–	–	–	–	–	–	14	–	–	4
Accounting changes	–	2	–	–	–	8	–	–	–	1
Other	–	–	–	–	–	–	–	–	3	–

Sources: Legislative Analyst Office’s state spending plans; various publications prepared by the Department of Finance pertaining to 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.

‡ Increased debt includes borrowing from internal sources.

Also, certain population segments, such as Medi-Cal recipients and higher education students, to which the State devotes considerable resources, continue to increase more quickly than the general population on which the State depends for income tax revenue. As shown in Table 2 on the following page, the State’s population as a whole increased by 4 percent from fiscal years 2005–06 to 2009–10, while the number of Medi-Cal recipients and students seeking higher education increased by 13 percent and 14 percent, respectively. Over this same period, the General Fund budget for Medi-Cal costs increased from \$12.8 billion to \$14.9 billion. This disproportionate growth in certain population segments continues to significantly affect the state budget.

**Table 2**  
**Growth Rate of California's General Population Compared to the Growth Rates of Specific Groups**

FISCAL YEAR	GENERAL POPULATION	INMATES	PERSONS ELIGIBLE FOR MEDI-CAL	K-12 STUDENTS	HIGHER EDUCATION STUDENTS
2005-06	37,275,000	172,561	6,534,981	6,312,436	2,129,185
2006-07	37,655,000	173,312	6,553,257	6,286,943	2,179,196
2007-08	38,156,000	170,973	6,721,002	6,275,469	2,281,431
2008-09	38,477,000	167,832	7,094,877	6,252,031	2,390,847
2009-10	38,827,000	165,817	7,390,537	6,190,425	2,427,996
<b>Increase from fiscal years 2005-06 through 2009-10</b>	<b>4%</b>	<b>(4)%</b>	<b>13%</b>	<b>(2)%</b>	<b>14%</b>

Sources: Department of Finance's Demographic Research Unit's population estimates; Department of Corrections and Rehabilitation, California Prisoners and Parolees 2009; Department of Education 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.

At the November 2, 2010 General Election, California voters approved Proposition 25, which changed the vote requirement to pass the state budget from a two thirds vote to a simple majority. While this change is expected to have a significant impact on the budget process, other factors remain that make it difficult for Legislatures to achieve a balanced budget. Some of these factors exist beyond legislative control, such as the initiative process itself which can result in voter-approved spending obligations that generally may not be modified without voter approval. In addition, Proposition 22, which was also approved by the voters at the 2010 General Election, prohibits the Legislature from borrowing revenues generated by the fuel excise tax and using those revenues for general fund purposes. The Cash Management Bureau Chief at the Controller's office states that this reduces the availability of resources against which the state may borrow to meet short term cash flow needs.

In addition, a change in federal law related to estate tax has resulted in lost revenue for the General Fund. Prior to January 2005 the State generally received about \$1 billion of the federal estate taxes that would have otherwise been paid to the Internal Revenue Service. These revenues are commonly known as a state *pick-up tax*. However, the Economic Growth and Tax Relief Reconciliation Act of 2001 and a subsequent amendment to it suspended the state pick-up tax so that, as of January 1, 2005, the State no longer receives this revenue. The pick-up tax is scheduled to be reinstated effective January 1, 2013. One way the State can make up for this lost revenue is by imposing a state estate tax. However, current state law, enacted through an initiative measure, prohibits California from imposing a state estate tax. Voter approval would be required to modify or repeal that prohibition.

**Table 3**  
**Ballot Measures Approved by Voters in November 2010 General Elections That Impact State Budget**

INITIATIVE	SUMMARY
Proposition 22	Prohibits the State from borrowing or taking funds used for transportation, redevelopment, or local government projects and services.
Proposition 25	Changes legislative vote requirement to pass budget and budget-related legislation from two-thirds to a simple majority. Retains the two-thirds vote requirement for taxes.
Proposition 26	Requires that certain state and local fees be approved by a two-thirds vote. Broadens the definition of a State or local tax to include payments currently considered to be fees or charges.

Source: Voter information guide for the November 2, 2010 election, prepared by the State Attorney General.

Finally, as we noted in our 2009 report, various legal, political, and humanitarian considerations make it difficult for decision makers to reduce expenditures to a level sufficient to eliminate the ongoing deficits. For example, the State must provide matching General Fund money to secure certain federal funding. Further, many expenditures are mandated by the California Constitution.

We will continue to monitor developments related to the state budget and to assist decision makers in finding areas to streamline expenses or increase revenues.

### Funding CalSTRS

We have added CalSTRS' Defined Benefit Program to the list of high-risk issues because the State faces the possibility of having to help finance CalSTRS' pension liabilities. The contributions required from CalSTRS members and their employers are currently not sufficient to ensure payment of all promised future benefits. The funded status of this program has decreased from 98 percent in 2001 to 71 percent in 2010, well below the 80 percent recommended for pension programs. As a result, it does not expect to be able to pay the retirement benefits beyond the next 30 years. Because the State is ultimately responsible for finding a way to fully fund the benefits promised to CalSTRS members, unless it takes steps to ensure adequate funding it may be responsible for supplementing CalSTRS members' retirement benefits.

CalSTRS was created to provide California teachers with a secure financial future during their retirement years and to provide an incentive for them to stay in the teaching profession their entire working careers. CalSTRS is responsible for administering the State Teachers' Retirement Plan, of which one of the programs, the Defined Benefit Program, provides defined retirement benefits to its members.

***The Defined Benefit Program is not currently funded at the level necessary, and contributions are not sufficient to pay retirement benefits to members beyond the next 30 years.***

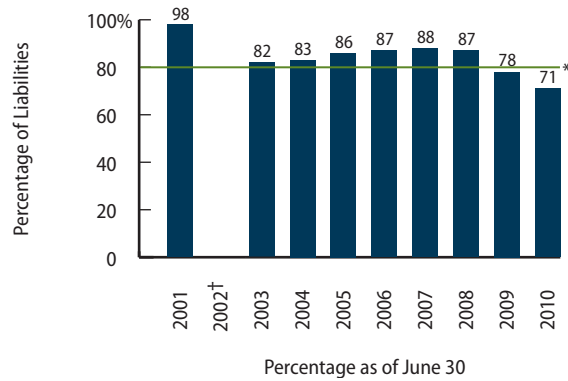
Membership in the Defined Benefit Program includes all employees in California public schools who are required by state law to participate. With more than 852,000 members and benefit recipients, CalSTRS is the nation's largest public teachers' pension organization. Retirement benefits are computed using a formula that takes into account the member's years of service, age, and final compensation. CalSTRS prefunds pension benefits by setting aside funds each year to pay for future pensions, in addition to paying the current year's pension obligations. The members, their employers, and the State are required to contribute a percentage of members' salaries to prefund pension benefits for CalSTRS members.

However, the required contributions for CalSTRS members and their employers have not changed in more than two decades. These contribution rates, unlike the rates for most national pension plans, including the California Public Employees' Retirement System, are established by state law. As a result, only the Legislature, not the CalSTRS board, has the authority to change the contribution rates. An employer's contribution to CalSTRS' Defined Benefit Program remains at 8.25 percent of the participating member's current salary, and the member's contribution rate has remained at 8 percent of his or her current salary since at least 1976. Further, recent changes in law have reduced the State's contribution to the Defined Benefit Program from the roughly 4 percent it paid two years ago to approximately 2 percent of the salaries of CalSTRS members. As a result, the Defined Benefit Program is not currently funded at the level necessary, and contributions are not sufficient to pay retirement benefits to members beyond the next 30 years.

To ensure that retirement systems have enough assets to provide pension benefits to members over the long run, these systems need to maintain a certain level of annual funding. According to a 2008 study by the U.S. Government Accountability Office, a sound pension program needs a funded ratio of 80 percent or better. This means that in any given year the pension program should have enough assets to cover at least 80 percent of its current-year and future pension liabilities. However, poor investment returns due to the economic recession and the inability to adjust funding contributions have caused the funded status of the CalSTRS Defined Benefit Program to decrease from 98 percent in 2001 to 71 percent in 2010, as shown in Figure 2. According to CalSTRS, although its pension liabilities for current and future retirees extend beyond the next 30 years, the program's assets, including expected future revenues, will be depleted within the next 30 years.

The State is ultimately responsible for finding a way to fully fund the benefits promised to CalSTRS members and beneficiaries in the event that a funding plan is not resolved. The CalSTRS board believes that it has the authority and the fiduciary responsibility to request that the State sufficiently fund the system to ensure a financially sound retirement system with stable and full funding over the long term.

**Figure 2**  
The Value of the Assets of the California State Teachers’ Retirement System Defined Benefit Program as a Percentage of Its Liabilities  
From June 30, 2001 Through June 30, 2010



Source: California State Teachers’ Retirement System (CalSTRS) Defined Benefit Program Actuarial Valuation as of June 30, 2010.

\* According to a study by the U.S. Government Accountability Office, a sound pension plan should have assets that are at least 80 percent of its current and future liabilities.

† Government Accounting Standards Board (GASB) No. 27: Accounting for Pensions by State and Local Government Employees only requires actuarial valuation to be performed biennially. Although CalSTRS performs such valuation each year, it did not do so in 2002.

Pension systems have extraordinarily long-lived liabilities—in some cases, promised benefits are required to be paid out in excess of 50 years past the date they are first offered. Indications that CalSTRS Defined Benefit Program may not be able to meet its retirement obligations beyond the next three decades are of significant concern. Unless the State takes steps to ensure that the CalSTRS Defined Benefit Program is adequately funded, it may be responsible for supplementing the necessary funding using taxpayer money. Therefore, we have designated CalSTRS Defined Benefit Program as a high-risk issue.

### Funding Retiree Health Benefits

As of June 30, 2010, California’s total estimated liability for retiree health benefits under its current funding method was \$59.9 billion, nearly \$12 billion more than the \$48.2 billion liability that existed as of June 30, 2008.<sup>4</sup> This liability presents a risk for the State in providing the level of health benefits promised to its retirees. Therefore, managing the State’s retiree health benefits liability continues to be a high-risk issue.

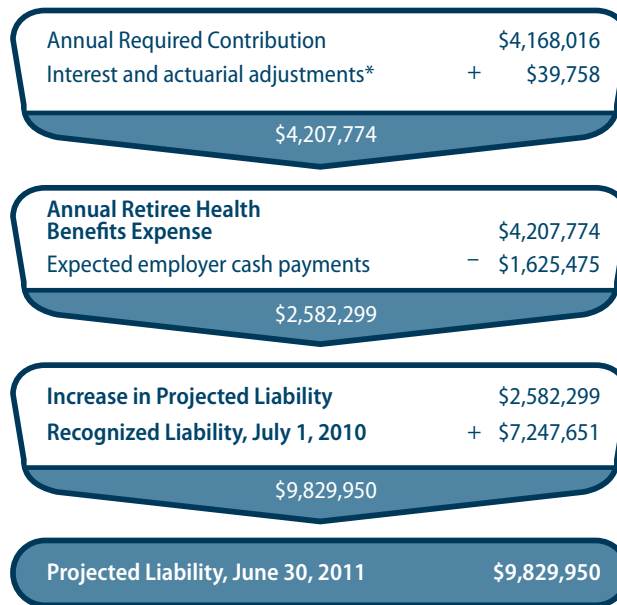
<sup>4</sup> These amounts do not include the University of California or the trial courts.

Liability for state retiree health benefits has continued to grow, with an associated increase in future General Fund expenditures, further burdening future generations of Californians. According to the State's most recent actuarial study, as of June 30, 2010, its total estimated retiree health benefits liability was \$59.9 billion. This amount represents, in today's dollars, the future cost of retiree health benefits that state employees have already earned. Currently, all of this liability is unfunded because unlike pension funds, the State has not established a trust or set aside any money to pay for retiree health benefits. Instead, the State continues to use a pay-as-you-go method of funding these benefits. Each year the State determines its annual required contribution, which is an actuarial determined level of funding that is projected to cover the cost of benefits earned during the current year and a portion of the cost for benefits earned in prior years if it is paid on an ongoing basis. However, under the pay-as-you-go method, the State addresses only the current year's cost of retirees' medical and dental insurance premiums and does not set aside funds to cover any future costs to the State. Because this method does not address the benefits that must be paid to state employees in the future, the future liability continues to grow.

For example, at the beginning of fiscal year 2010–11, the State had a recognized liability, which is the unpaid accumulated annual required contributions from prior years, of \$7.2 billion for retiree health benefits. In fiscal year 2010–11, the State's annual required contribution was \$4.2 billion. This amount would have paid for that year's benefits earned and a portion of the benefits earned in previous years. Including the interest and adjustments resulting from the fiscal year 2009–10 contribution deficiency, the State needed to pay \$11.4 billion to ensure that there was no liability for financial reporting purposes at the end of fiscal year 2010–11. However, the State was expected to pay only \$1.6 billion, representing the payment due for that year's premiums. As Figure 3 shows, the projected retiree health benefits liability as of the end of fiscal year 2010–11 increased to \$9.8 billion.

Other methods of funding retiree health benefits include either partial or full-funding of the total liability. Prefunding retiree health benefits—setting aside assets in advance to earn additional money over time—whether partially or in full, would reduce the annual required contribution and unfunded liability. As Table 4 on page 20 shows, the State could reduce its total liability by more than \$21 billion by committing to fully prefunding retiree health benefits in fiscal year 2010–11 and subsequent years. Even partially prefunding retiree health benefits at 50 percent during fiscal year 2010–11 and subsequent years, as shown in Table 4, would reduce the State's total liability by about \$12.5 billion.

**Figure 3**  
**Projected Calculation of the State’s Liability for Retiree Health Benefits**  
**Fiscal Year 2010–11**  
**(in Thousands)**



Sources: State of California Retiree Health Benefits Program; Government Accounting Standards Board Nos. 43 and 45; Actuarial Valuation Report as of June 30, 2010.

Note: This calculation does not include the University of California or trial courts.

\* This amount is the interest on the July 1, 2010, retiree health benefits liability and an actuarial adjustment resulting from the fiscal year 2009–10 contribution deficiency.

California is not alone in facing the issue of funding retiree health benefits. An April 2011 Pew Center on the States report titled *The Widening Gap: The Great Recession’s Impact on State Pension and Retiree Health Care Costs* (Pew report) indicates that states that have made significant promises for retiree health care and other benefits could face an enormous fiscal burden in the future if they do not set aside more savings or better manage costs. According to the Pew report as of the end of fiscal year 2008–09, 19 states, including California, had retiree health benefits liabilities that are almost entirely unfunded as of the most recent fiscal year. Further, many states, including California, have contributed less than 50 percent of their annual required contributions.



**Table 4**

**Comparison of the Effects on Liabilities of California's Contributing Different Levels of Cash Payments for Retiree Health Benefits**  
Fiscal Year 2010–11  
(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*	4.5% <sup>†</sup>	6.13%	7.75%
<b>Total estimated liability for retiree health benefits as of June 30, 2010</b>	<b>\$59.91</b>	<b>\$47.43</b>	<b>\$38.47</b>
Savings over pay-as-you-go funding policy	–	12.48	21.44
<b>Annual required contribution</b>	<b>4.17</b>	<b>3.42</b>	<b>2.93</b>
Savings over pay-as-you-go funding policy	–	0.75	1.24
<b>Expected employer cash payments</b>	<b>1.63</b>	<b>2.28</b>	<b>2.93</b>
<b>Projected liability for fiscal year 2010–11</b>	<b>9.83</b>	<b>8.48</b>	<b>7.39<sup>‡</sup></b>

Sources: State of California Retiree Health Benefits Program; Government Accounting Standards Board Nos. 43 and 45; Actuarial Valuation Report as of June 30, 2010.

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

\* Government 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 retiree health benefits as they come due.

<sup>†</sup> Although the actuarial study based this 4.5 percent interest rate for the State's Pooled Money Investment Account on a long-term perspective, the actual rate of return on these underlying investments will vary.

<sup>‡</sup> Under the full-funding policy, this amount is any previously recognized retiree health benefits liability for prior fiscal years, including interest and actuarial adjustments.

Although the State has taken some steps to address its growing liability for retiree health benefits, these efforts are not enough to fully resolve this issue. In an effort to manage rising health care costs and achieve cost savings, legislation that took effect March 24, 2011, requires the Board of Administration of the Public Employees' Retirement System to negotiate with carriers offering health benefit plans to add a less expensive health plan option to the existing portfolio of health plans or to implement other measures to achieve ongoing cost savings beginning in fiscal year 2012–13. Further, the State has unsuccessfully attempted to prefund retiree health benefits and continues to search for mechanisms to reduce these costs. Between January 2010 and June 2010, the State and the California Association of Highway Patrolmen (CAHP) briefly prefunded approximately \$4.8 million in retiree health benefits. However, subsequent bargaining unit agreements temporarily redirected those contributions away from prefunding retiree health benefits. The State plans to resume or begin prefunding the retiree health benefit liability for the CAHP and certain other state employees at a later date. However, it remains unclear whether the State will begin prefunding this liability for all other employees and how the State will manage the risks associated with its large and growing retiree health benefits liability.

## Ensuring Timely Expenditure of Recovery Act Funds

The State is at risk of losing some of the \$8.6 billion in Recovery Act funds that remain unspent as of March 31, 2011. Various state programs must ensure that these funds are spent before the respective deadlines for spending these funds end to avoid having to forfeit them to the federal government. Further, many state departments continue to have a significant number of internal control weaknesses related to their administration of federal programs and Recovery Act grants. Finally, a recent report by the U.S. Department of Education's Office of the Inspector General found instances of improper use of Recovery Act funds by selected local educational agencies. Because of the significant amount of funds involved, and because California has demonstrated weaknesses in the administration of the programs for which these funds have been awarded, administration of Recovery Act funds continues to be a high-risk issue for the State.

Imminent deadlines for spending some of the Recovery Act funds place greater emphasis on the departments' ability to ensure that the entire award is spent before the funds revert. Many of the Recovery Act awards contain a spending deadline by which the State must ensure that the full amounts awarded are used for the purposes intended. As shown in Table 5 on the following page, the four departments we reviewed—the Department of Education (Education), the Employment Development Department (Employment Development), the Department of Health Care Services (Health Care Services), and the Department of Social Services (Social Services)—reported spending \$26 billion of the \$29 billion in Recovery Act funds awarded to them by the federal government. Any unspent funds for these grants after the respective deadline must revert to the federal government.

For some programs, the spending deadlines already passed and the unspent Recovery Act funds reverted to the federal government. For example, the spending deadline for the Emergency Contingency Fund for Temporary Assistance for Needy Families State Program, administered by Social Services, was September 30, 2010. Although Social Services noted that it has not finalized the expenditures for this grant as of July 2011, it expects that it will have to revert roughly \$35 million to the federal government. Social Services explained that only \$5 million of the \$40 million estimated for a contract to pay household utility payments for program beneficiaries was actually spent due to complex eligibility determinations and overall difficulties in administering the program, and because the process to draft and approve the necessary contract limited the time available to spend the money. Similarly, Education and Social Services did not fully spend Recovery Act funds awarded to them for Child Nutrition and

*Any unspent funds for these grants must revert to the federal government at the end of the period of availability.*

the Emergency Food Assistance Program (Administrative Cost), respectively. As a result, these departments forfeited a combined total of \$736,303. Both departments indicated that accounting and cost adjustments at the state or local level caused them to have unexpended funds that reverted to the federal government.

**Table 5**  
**American Recovery and Reinvestment Act of 2009 Funds Expended and Remaining for the Four Departments We Reviewed as of March 31, 2011**

DEPARTMENT/GRANT	TOTAL RECOVERY ACT AWARD	RECOVERY ACT FUNDS SPENT	RECOVERY ACT FUNDS REMAINING	PERCENTAGE REMAINING	SPENDING DEADLINE
<b>American Recovery and Reinvestment Act of 2009 (Recovery Act) funds administered by the State</b>	<b>\$38,811,804,746</b>	<b>\$30,210,751,784</b>	<b>\$8,601,052,961</b>	<b>22.2%</b>	
<b>Recovery Act funds awarded to the Departments of Education, Social Services, Health Care Services, and the Employment Development Department</b>	<b>\$29,275,197,883</b>	<b>\$26,312,883,448</b>	<b>\$2,962,314,435</b>	<b>10.1%</b>	
<b>Department of Education</b>	<b>\$6,253,587,701</b>	<b>\$5,129,986,332</b>	<b>\$1,123,601,369</b>	<b>18%</b>	
Child Nutrition Programs	12,864,683	12,174,129	690,554	5.4	September 30, 2010
Child Care and Development Block Grant	220,273,864	206,939,203	13,334,661	6.1	September 30, 2011
State Fiscal Stabilization Fund - Education State Grants	3,190,419,360	2,858,293,390	332,125,970	6.8	December 31, 2011
Title I Grants to Local Educational Agencies	1,124,920,473	903,111,084	221,809,389	19.7	December 31, 2011
Special Education Grants to States	1,226,944,052	1,038,313,306	188,630,746	15.4	December 31, 2011
Education Technology State Grants	71,578,424	18,200,000	53,378,424	74.6	December 31, 2011
Individuals with Disabilities Education Act, Part B, Section 619	41,028,219	29,332,333	11,695,886	28.5	December 31, 2011
Education for Homeless Children and Youth	13,795,989	9,562,517	4,250,837	30.8	December 31, 2011
School Improvement Grants	351,762,637	54,060,370	297,702,267	84.6	September 30, 2013
<b>Department of Health Care Services</b>	<b>\$12,880,200,000</b>	<b>\$11,336,300,000</b>	<b>\$1,543,900,000</b>	<b>12.0%</b>	
Medical Assistance Program	12,880,200,000	11,336,300,000	1,543,900,000	12.0	June 30, 2011
<b>Department of Social Services</b>	<b>\$1,486,004,765</b>	<b>\$1,333,759,016</b>	<b>\$152,245,749</b>	<b>10.2%</b>	
Emergency Contingency Fund for Temporary Assistance for Needy Families State Program	1,253,500,000	1,112,200,000	141,300,000	11.3	September 30, 2010
Emergency Food Assistance Program (Administrative Costs)	10,004,765	9,959,016	45,749	0.5	September 30, 2010
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	21,700,000	21,700,000	-	-	September 30, 2010
Adoption Assistance	97,100,000	90,400,000	6,700,000	6.9	June 30, 2011
Foster Care Title IV-E	103,700,000	99,500,000	4,200,000	4.1	June 30, 2011
<b>Employment Development Department</b>	<b>\$8,655,405,417</b>	<b>\$8,512,838,100</b>	<b>\$142,567,317</b>	<b>1.6%</b>	
Workforce Investment Act Dislocated Workers	488,646,876	407,448,466	81,198,410	16.6	June 30, 2011
Employment Service/Wagner-Peyser funded activities	46,970,564	42,980,106	3,990,458	8.5	June 30, 2011
Program of competitive grants for worker training and placement in high growth and emerging industry sectors	1,250,000	784,677	465,323	37.2	December 31, 2011
Workforce Investment Act Dislocated Workers, extended	9,990,477	1,283,462	8,707,015	87.2	June 30, 2012

DEPARTMENT/GRANT	TOTAL RECOVERY ACT AWARD	RECOVERY ACT FUNDS EXPENDED	RECOVERY ACT FUNDS REMAINING	PERCENTAGE REMAINING	SPENDING DEADLINE
Program of competitive grants for worker training and placement in high growth and emerging industry sectors	547,500	–	547,500	100.0	June 30, 2012
Program of competitive grants for worker training and placement in high growth and emerging industry sectors	6,000,000	941,389	5,058,611	84.3	January 28, 2013
Unemployment Insurance - special transfer in fiscal year 2009–10 for administration	59,900,000	17,300,000	42,600,000	71.1	NA
Extension of emergency unemployment compensation program	5,241,800,000	5,241,800,000	–	–	NA
Federal funding for extended unemployment program	1,514,600,000	1,514,600,000	–	–	NA
Federal additional unemployment compensation program	1,285,700,000	1,285,700,000	–	–	NA

Sources: California Recovery Task Force, California Department of Education, Department of Health Care Services, Department of Social Services, and Employment Development Department (Employment Development).

NA = Not applicable. The U.S. Department of Labor and Employment Development indicated that the Unemployment Insurance - special transfer in fiscal year 2009–10 for administration program, Extension of Emergency Unemployment Compensation program, Federal Funding for Extended Unemployment program, and Federal Additional Unemployment Compensation program have no deadline by which grant funds must be spent.

Further, the spending deadline for five other grants was June 30, 2011. Although Employment Development has not finalized its expenditures for Employment Services/Wagner-Peyser Funded Activities and the Workforce Investment Act Dislocated Workers program, it believes that it has fully spent these two grants and that the funds for these grants will not revert to the federal government. Moreover, Social Services and Health Care Services have also not finalized their expenditures for the remaining three grants that expire on June 30, 2011; but, they believe that they were limited in their ability to spend Recovery Act funds for these grants and that the unspent funds do not represent a loss to the State. Specifically, the departments stated that the Recovery Act funds awarded for Foster Care Title IV-E, Adoption Assistance, and Medical Assistance Program (Medicaid) were to supplement the benefits provided under the regular federal grants that these departments administer. As such, the Recovery Act funds supplemented, to a certain extent, those expenditures that the State would have had to pay from nonfederal sources. For example, the federal Medicaid program generally pays 50 percent of the benefits provided to the beneficiaries. The State must pay the remaining 50 percent using nonfederal funds. The federal government allocated \$12.9 billion in Recovery Act funds to Health Care Services to pay up to an additional 11.6 percent of the benefits provided under Medicaid, effectively reducing the State's share of the cost. Health Care Services noted that the Medicaid benefits provided during the time allowed by the Recovery Act grant did not allow it to use all grant funds allocated to the State. Social Services noted similar reasons for not being able to use all Recovery Act funds for the other two grants.

Although we determined that departments have made some progress in improving their internal controls over the administration of federal funds, weaknesses in this area continue to be an issue. The four departments we reviewed administered almost 80 percent of all Recovery Act funds awarded to all state departments. Each of these departments had an equal number or fewer internal control findings in fiscal year 2009–10 compared to fiscal year 2006–07. As Table 6 shows, the total number of internal control findings for these four departments fell from 45 in fiscal year 2006–07 to 31 in fiscal year 2009–10. Nevertheless, the fact remains that these departments continue to have weaknesses in their internal controls over federal programs they administer.

**Table 6**  
**Internal Control Findings for Selected State Departments**  
**Fiscal Years 2006–07 Through 2009–10**

DEPARTMENT	FISCAL YEARS			
	2006–07	2007–08	2008–09	2009–10
Department of Education	21	26	23	16
Employment Development Department	5	7	5	3
Department of Health Care Services	15	10	9	8
Department of Social Services	4	12	14	4
<b>Totals</b>	<b>45</b>	<b>55</b>	<b>51</b>	<b>31</b>

Source: Information from Bureau of State Audits' reports 2007-002, 2008-002, 2009-002, and 2010-002. Bureau of State Audits' Internal Control and State and Federal Compliance Audit Report for Fiscal Years ended June 30, 2007; June 30, 2008; June 30, 2009; and June 30, 2010.

We have also identified weaknesses in the administration of Recovery Act funded programs by other state agencies. Specifically, a series of reports we issued in 2009 and 2010 on the administration of certain Recovery Act funds awarded to the California Energy Resources Conservation and Development Commission (Energy Commission),<sup>5</sup> the Department of Community Services and Development (Community Services),<sup>6</sup> the Department of Housing and Community Development (Housing and Development),<sup>7</sup> and the California Emergency

<sup>5</sup> *California Energy Resources Conservation and Development Commission: It Is Not Fully Prepared to Award and Monitor Millions in Recovery Act Funds and Lacks Controls to Prevent Their Misuse* (Report 2009-119.1, December 2009).

<sup>6</sup> *Department of Community Services and Development: Delays by Federal and State Agencies Have Stalled the Weatherization Program and Improvements Are Needed to Properly Administer Recovery Act Funds* (Report 2009-119.2, February 2010).

<sup>7</sup> *Department of Housing and Community Development: Despite Being Mostly Prepared, It Must Take Additional Steps to Better Ensure Proper Implementation of the Recovery Act's Homelessness Prevention Program* (Report 2009-119.3, February 2010).

Management Agency (CalEMA)<sup>8</sup> identified several weaknesses in the respective agencies' abilities and preparedness to administer specific Recovery Act awards. For instance, we reported that the Energy Commission was slow in developing guidelines and implementing the internal controls needed to administer the Recovery Act funds for its State Energy Program. We also found, among other things, that Housing and Development had not yet developed a written plan for monitoring its subrecipients, and that Community Services needed to improve its procedures for managing federal cash for the weatherization program and, at the time of our review, had not yet used its Recovery Act funds for any weatherization projects. Further, we reported that CalEMA needed to improve its monitoring of Recovery Act Edward Byrne Memorial Justice Assistance Grant Program funds it had awarded.

Our recent updates on some of these reports found additional issues. For example, the bureau's July 2011 letter report concluded that Community Services<sup>9</sup> faces challenges in its efforts to determine how to allocate the remaining funds to maximize production and weatherize enough homes to ensure that the grant funds are spent so that they do not revert by the March 31, 2012 deadline, while also ensuring that it meets its production goals under the annual weatherization grants that expire June 30, 2012. Additionally, a second July 2011 letter report<sup>10</sup> concluded that as of June 9, 2011, \$69.9 million in reported expenditures, or 31 percent of the \$226 million in Recovery Act funds administered by the Energy Commission, do not reflect the amount of Recovery Act funds actually spent for State Energy Program projects. Based on its agreement with the U.S. Department of Energy, the Energy Commission must spend the remaining funds by April 30, 2012 and, according to the Energy Commission's deputy director of the Administrative Services Division, the Energy Commission is on track to fully use the Energy Program funds by that date. However, we could not verify portions of the Energy Commission's efforts to monitor the status of projects and subgrant funds it had awarded because it was not always able to provide evidence sufficient to support its assertions. Finally, our high-risk report dated December 2010 indicated that state agencies did not always report the Recovery Act jobs data accurately.<sup>11</sup>

***We could not verify portions of the Energy Commission's efforts to monitor the status of projects and subgrant funds it had awarded because it was not always able to provide evidence sufficient to support its assertions.***

<sup>8</sup> *California Emergency Management Agency: Despite Receiving \$136 Million in Recovery Act Funds in June 2009, It Only Recently Began Awarding These Funds and Lacks Plans to Monitor Their Use* (Report 2009-119.4, May 2010).

<sup>9</sup> *Department of Community Services and Development: Status of Funds Provided Under the American Recovery and Reinvestment Act of 2009 for the Weatherization Assistance for Low-Income Persons Program* (Report 2011-503.2, July 2011).

<sup>10</sup> *California Energy Resources Conservation and Development Commission: Status of Funds Provided Under the American Recovery and Reinvestment Act of 2009 for the State Energy Program* (Report 2011-503.3, July 2011).

<sup>11</sup> *High Risk Update—American Recovery and Reinvestment Act of 2009: The California Recovery Task Force and State Agencies Could Do More to Ensure the Accurate Reporting of Recovery Act Jobs* (Report 2010-601, December 2010).

***The overall spending for one grant appears insufficient to ensure that all funds are spent before the spending deadline.***

Moreover, the U.S. Department of Education's Office of the Inspector General issued a report in April 2011 on selected local educational agencies and Education's administration of Recovery Act funds that identified instances of noncompliance with applicable federal requirements, resulting in improper use of Recovery Act funds.<sup>12</sup> According to the report, about \$23,000 of the \$771,000 in local educational agency charges of Recovery Act funds for Title I, Part A, of the Elementary and Secondary Education Act reviewed by the federal Inspector General were for unallowable personnel and entertainment costs. In addition, the report described significant data quality issues related to reporting on the number of jobs created or retained using Recovery Act funds.

Further, the letter report the bureau issued in August 2011<sup>13</sup> found that the State is at risk of having to return to the federal government some Recovery Act funds for various programs that Education administers. Education awards most funds for the eight Recovery Act grants that it currently administers to subrecipients, which are responsible for spending the funds. One of the grants that Education administers has a spending deadline of September 30, 2011 and six others have a spending deadline of December 31, 2011. However, the overall spending for one of these seven grants appears insufficient to ensure that all funds are spent before the deadline. Specifically, subrecipients for the Education Technology State Grants spent an average of only \$9.5 million per quarter. With the fast approaching spending deadline, assuming that the pace of spending does not change substantially, the subrecipients will have spent just 81 percent of the \$71.6 million for the Education Technology State Grants before the deadline.

In addition, although based on their overall spending the remaining six Recovery Act grants that must be spent on or before December 31, 2011 appear to be on track to be substantially spent before the spending deadline, some of the subrecipients that received the funds for these grants have spent very little and do not appear to be on track to use all of the funds awarded to them. For example, although based on the current pace of spending it appears that subrecipients will have fully spent by December 31, 2011, substantially all of the State Fiscal Stabilization Fund-Education State Grants funds Education awarded to 1,518 subrecipients, 76 subrecipients had spent 50 percent or less of their awards as of June 30, 2011. With only two quarters remaining before the spending deadline, these subrecipients must spend a combined total

<sup>12</sup> *American Recovery and Reinvestment Act-California: Use of Funds and Data Quality for Selected American Recovery and Reinvestment Act Funds* (Report ED-OIG/A09K0002, April 2011).

<sup>13</sup> *Department of Education: Status of Funds Provided Under the American Recovery and Reinvestment Act of 2009 for Various Grants* (Report 2011-503.4, August 2011).

of \$64 million. Education noted that it periodically sends reminder letters to encourage subrecipients to spend their remaining Recovery Act funds. However, Education cannot force subrecipients to spend their awards at an increased pace to ensure that all funds are spent before grant deadlines. Nevertheless, because subrecipients must spend these funds on allowable activities, the short amount of time remaining to spend the Recovery Act funds increases the risk that Recovery Act funds could either revert or be used inappropriately.



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## Chapter 2

### MANAGING THE STATE'S PRISON POPULATION AND CORRECTIONAL INSTITUTIONS

In 2006 the Bureau of State Audits (bureau) designated the California Department of Corrections and Rehabilitation (Corrections) as a high-risk department because of litigation related to overcrowding in its prisons, its inability to achieve or maintain a constitutional level of health care for its prison inmates, and issues related to the consistency of its leadership in upper management. Although Corrections has made progress in providing health care to its inmates over the last four years, a recent decision by the U.S. Supreme Court will require Corrections to reduce its prison overcrowding, and the department's recent reorganization will continue to affect its ability to provide consistent leadership. For these reasons, Corrections continues to represent a high risk to the State.

#### Reducing Overcrowding in the State's Prisons

The State's correctional institutions house well over the maximum level ordered by a federal court. As a result, Corrections may have to reduce its prison population or construct additional prisons to comply with the federal court's ruling. However, little progress has been made in this area. Recent legislation should reduce the prison populations in state prisons, although the impact of this legislation is currently unknown. Given that Corrections must ensure that its prison population is no more than 137.5 percent of prison capacity within two years, prison overcrowding remains an area of high risk.

Corrections' data show that as of June 8, 2011, the number of inmates housed in adult institutions caused the system to reach 180.2 percent of their design capacity. Design capacity refers to the number of inmates a prison can hold based on one prisoner per cell. On May 23, 2011, the U.S. Supreme Court (Supreme Court) upheld a 2009 lower court ruling requiring Corrections to reduce its prison population to 137.5 percent of design capacity by May 2013.<sup>14</sup> Complying with this ruling would require Corrections to either release 34,000 prisoners, increase design capacity by constructing new beds, or implement some combination of these two options. The lower court stated in its prior ruling that overcrowding was the primary cause for the unconstitutional level of medical care found in California's prisons, and that a prisoner release order may be the most compelling means for relief.

<sup>14</sup> (Brown, Governor of California et al. v. Plata et al.)

***AB 900 of the 2007 Regular Session provides funding to Corrections in two phases to construct additional beds, yet four years after the passage of the law, Corrections has shown little progress in construction.***

The Supreme Court stated that the lower court retains the authority to further amend its existing order and may extend the May 2013 deadline, though it noted that even with an extension of time to construct new facilities and implement other reforms, it may become necessary to release prisoners to comply with the court's order.

Assembly Bill 900 of the 2007 Regular Session (AB 900) authorizes Corrections to construct and renovate prison space and to initiate and improve rehabilitation programs to reduce prison overcrowding. Specifically, AB 900 provides funding to Corrections in two phases to construct additional beds. However, four years after the passage of the law, Corrections has shown little progress in construction. In fact, as shown in Figure 4, as of April 2011, AB 900 construction has not increased the design capacity of state prisons. Only one AB 900 project had been completed, adding a total of 50 medical beds, some of which are used for short-term medical treatment and do not, therefore, increase the prison's overall capacity. Furthermore, some of the medical beds Corrections is creating are not new beds, but rather beds that are being altered from their original purpose of housing prisoners to serve a medical purpose. The construction involved in repurposing these beds creates new medical treatment and office areas and allows Corrections to better serve inmates already housed in those areas. Although medical beds increase the ability to provide medical care, not all increase design capacity.

Six AB 900 projects are currently under construction. Once they are completed, Corrections estimates they will add 1,831 design capacity beds, 1,781 medical beds, and 808 repurposed beds to the prison system. Corrections expects these projects to be completed between October 2011 and July 2013. Seven additional projects, adding 1,814 design capacity beds and 675 repurposed beds, are in the design phase, and Corrections' planned completion dates for those projects are between February 2013 and October 2013. In total, through AB 900 Corrections has created, is constructing, or is designing a total of 3,645 design capacity beds, 1,831 medical beds, and 1,483 repurposed beds. However, this increase in prison bed capacity will not come in time to reduce prison overcrowding to 137.5 percent of design capacity as required by the federal ruling.

**Figure 4**  
Timeline of Actual and Planned Completion Dates and Numbers of Beds to Be Constructed Under Assembly Bill 900, as of March 2011



Source: Auditor-generated based on information from California Department of Corrections and Rehabilitation's chief deputy secretary of Facility Planning, Construction, and Management and acting director of Division of Planning, Acquisition and Design.

\* Design capacity beds are beds that increase a facility's overall capacity for housing inmates.

† Medical beds include short-term medical treatment beds that do not increase design capacity and long-term medical treatment beds that can increase design capacity. Medical beds include those designated by Corrections as Correctional Treatment Center beds, Mental Health Crisis Beds, Medical-Low Beds, Medical-High Beds, Acute Psych, Intermediate Care Facility, and Intermediate Care Facility-High.

‡ Repurposed beds are not new beds and do not serve new prisoners. Instead, Corrections creates new treatment and office buildings to better serve inmates with mental health or medical needs.

● Denotes that the project is under construction.

● Denotes that the project is being planned.

Although Corrections expects to receive the funding through the second phase of AB 900, it must first meet all 13 benchmarks outlined in the legislation. The benchmarks cover a broad spectrum of objectives such as the number of beds under construction for medical, dental, and mental health purposes; creation of the California Rehabilitation Oversight Board; and the implementation of a plan to address management deficiencies that Corrections is struggling to address, as we discuss later. Further, the funding for the second phase is to be made available over a long-term period. Considering that Corrections has only until May 2013 to ensure that its prison population is no more than 137.5 percent of the capacity, the additional funding may not come in time to help with this effort.

In addition to increasing capacity, the State has taken some steps to reduce the prison populations in Corrections' prisons. In 2011 legislation was passed that reclassifies certain crimes that formerly required incarceration in state prisons. Under Assembly Bill 109 (AB 109) many felonies that are not classified as violent or serious will no longer result in a prison sentence; instead, the offender will serve his or her term in a county jail. Additionally, AB 109 transfers the responsibility of monitoring many parolees from the State to the counties and makes parole violations subject to time in a county jail, rather than a state prison. The 2011–12 Budget Act, which was signed into law in June 2011, makes money available for this purpose. Another bill that took effect on June 30, 2011, delayed implementation of AB 109 until October 2011. Corrections plans to begin implementing the changes in AB 109 as soon as certain provisions of the law go into effect. However, Corrections anticipates that the full impact of AB 109 will not be immediate.

Finally, Corrections noted that a law enacted in 2009 will also help reduce prison overcrowding. Specifically, Senate Bill 18 of the Third Extraordinary Session of 2009 (SBX3-18), changed the Penal Code to decrease the number of parolees returned to prison for parole violations. This bill increases the dollar threshold above which theft and certain property crimes are classified as felonies as opposed to misdemeanors, from \$400 to \$950. In addition, the bill allows prisoners to receive up to six weeks of credit toward their sentence each year for completing programs in prison, creates a fund to aid communities in rehabilitating parolees, institutes irrevocable parole for some parolees, and creates reentry courts. Although the total effect of this legislation is unknown, Corrections believes that this bill has contributed to a drop in the prison population, and will continue to reduce the prison population in the future. However, given that as of June 8, 2011, Corrections needed to reduce its prisoner population by 34,000 within two years in order to meet the federal court's ruling, the various initiatives it is undertaking may prove to be inadequate.

***Although the total effect of this legislation is unknown, Corrections believes that this bill has contributed to a drop in the prison population, and the reduction will continue in the future.***

## Improving Medical Care for Prisoners

Prison health care reform is a costly process, and although the federal health care receiver (receiver) has reported successes in its efforts to increase the quality of medical care for California's inmate population, it has also reported challenges. Due to the continuing work to bring California's medical care for inmates to a constitutionally adequate level, this issue remains on our high-risk list.

In February 2006 the U.S. District Court for the Northern District of California (District Court) appointed the receiver to oversee the State's prison health care system and ordered him to remain in place until the court was satisfied that the State had the will, capacity, and leadership to maintain a system for providing constitutionally adequate health care to inmates. According to data reported in several governor's budgets and information provided by the receiver, costs directly attributable to the delivery of medical care for inmates in California prisons have grown from \$841 million in fiscal year 2005–06 to a high of \$1.9 billion in fiscal year 2008–09, with \$1.5 billion budgeted in fiscal year 2011–12. However, the receiver's total costs are higher still because the receiver is also responsible for some portion of Corrections' overall overhead allocations. Corrections' total overhead costs ranged from \$210 million in fiscal year 2005–06 to a budgeted \$457 million in fiscal year 2011–12. Furthermore, until fiscal year 2010–11 the receiver included the cost of transporting and guarding prisoners for medical treatment in its budget. The costs to the receiver for this service varied from \$65 million in fiscal year 2005–06 to an estimated high of \$281 million in fiscal year 2008–09. According to the associate director of the receiver's fiscal management branch, as of July 2010 these costs have completely reverted to Corrections because they involve access to care and not the provision of care.

The receiver reported both successes and challenges in its latest report to the District Court. In June 2008 the District Court approved the receiver's updated Turnaround Plan of Action (turnaround plan). Of the 48 discrete actions in its 17<sup>th</sup> triannual report dated May 15, 2011, the receiver identified 34 as complete and 14 as in process or ongoing. In our 2009 high risk report, we noted that, of the 46 actions identified in the 10<sup>th</sup> triannual report, two actions had been completed, 23 were on schedule for completion, and 21 were either delayed or not progressing. A specific success the receiver reported in the 17<sup>th</sup> triannual report was the filling of executive positions throughout the State. The receiver also identified the State's fiscal crisis as having an impact on productivity and the timelines for implementing solutions to the issues it faces.

*Costs directly attributable to the delivery of medical care for inmates in California prisons have grown tremendously.*

*The inspector general found that nearly all prisons were not effective in ensuring that inmates receive their medications and that they are seen or provided services for routine, urgent, and emergency medical needs according to set timelines.*

To evaluate and monitor the progress of medical care delivery to inmates at each prison, the receiver requested that the California Office of the Inspector General (inspector general) for Corrections conduct an objective, clinically appropriate, and metric-oriented medical inspection program. To fulfill this request, the inspector general assigns a score to each prison based on multiple metrics to derive an overall rating of zero to 100 percent. Although only the federal court may determine whether a constitutional standard for medical care has been met, the inspector general uses the Receiver's scoring criteria for three levels of adherence to policies and procedures, with 75 percent being moderate adherence. Scores below 75 percent denote low adherence, while those above 85 percent reflect high adherence. Using this tool, the inspector general has rated California's 33 adult institutions at 72.9 percent, on average. It reported on each adult institution in California at least once between November 2008 and May 2011, and reported on seven institutions twice. Six of the seven institutions received a higher score upon the second visit, while one institution scored 0.4 percent lower in its second review. High Desert State Prison scored lowest, at 62.4 percent, and Folsom State Prison received the highest score, at 83.2 percent. The inspector general found that nearly all prisons were not effective in ensuring that inmates receive their medications. In addition, prisons were generally not effective at ensuring that inmates are seen or provided services for routine, urgent, and emergency medical needs according to timelines set by Corrections' policy. However, the inspector general did find that prisons generally performed well in areas involving duties performed by nurses, and in the continuity of care.

### **Maintaining Consistent Leadership**

Corrections continues to struggle with ensuring consistent leadership. Although it has made progress toward achieving the goals outlined in its new strategic plan, many vital positions remain unfilled. In addition, a recent reorganization of the department jeopardizes Corrections' ability to ensure consistent leadership. Finally, in order to receive its second phase of funding for construction of additional beds under AB 900, Corrections must demonstrate that it has filled at least 75 percent of its management positions for at least six months. As a result, maintaining consistent leadership remains a high risk for Corrections.

Since our 2009 high risk report, Corrections has implemented a strategic plan covering the years from 2010 through 2015. The strategic plan has four goals with 26 objectives. Corrections has developed a Web site on its intranet to track its progress against these objectives. This Web site generates charts detailing the number of on-time milestones and the implementation progress

for each objective. According to updates posted on its Web site regarding its progress, as of July 26, 2011, over 80 percent of the tasks associated with two of its four goals were on schedule, and between 60 percent and 80 percent of the tasks for the remaining two goals were on schedule.

Although it has established a strategic plan, Corrections remains unable to fully staff its management and warden ranks. A lack of consistent leadership at the top and in its upper- and mid-level management hampers Corrections' ability to succeed. Corrections' vacancy rate in its top administration and warden positions was 34 percent in 2007. That rate dropped to 30 percent in 2009, but by May 2011, 38.2 percent of these positions either were vacant or were filled in an acting capacity. According to Corrections, 12 of its 33 wardens—more than 36 percent—were serving in an acting role. Furthermore, our review of top administration positions revealed that nearly 41 percent of these positions were vacant or filled in an acting capacity. Additionally, a recent restructuring of Corrections by the governor eliminated 32 executive level positions and over 100 manager and supervisor positions. As a result, consistent leadership will continue to be an area of high risk for Corrections.



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## Chapter 3

### MODERNIZING AND IMPROVING STATE-FINANCED INFRASTRUCTURE

The State's aging infrastructure and its ability to supply reliable electricity to its residents remain areas of high risk. The State issued bonds to partially finance the upgrades of its infrastructure; however, it continues to struggle with ensuring bond accountability. Further, continuing budget problems have steered the focus away from improving infrastructure. In addition, uncertainties exist regarding requirements to retrofit or replace certain environmentally harmful power plants, as well as the State's ability to meet its new target for renewable energy. Therefore, maintaining and improving the State's infrastructure and the production and delivery of electricity remain areas of high risk.

#### Upgrading and Expanding the State's Infrastructure

Issues involving accountability for the State's infrastructure bonds, as well as the State's shift of focus away from infrastructure projects due to budget issues and the economic recession, mean that the State's infrastructure remains on our list of high-risk issues faced by the State.

At the time of the State's most recent road assessment, issued in March 2008, approximately 13,000 miles, or 26 percent, of the State's roadways were in fair or poor condition. To improve the conditions of the State's infrastructure, voters approved \$42.7 billion in bonds to partially fund the State's strategic growth plan to rebuild California's infrastructure. The total investment called for in the plan is more than \$500 billion. Due to the size of this undertaking, the former governor issued an executive order to ensure accountability for the expenditures of funds received from these bonds.

We found numerous problems related to bond accountability. Our May 2011 report related to bonds for water projects<sup>15</sup> found that the Department of Finance (Finance) lacks procedures to ensure that agencies administering bond-funded projects update the bond accountability Web site required by the executive order and that the project information on the Web site is complete and accurate. Further, the Department of Water Resources (Water Resources) did not post all project information to the Web site, omitting

<sup>15</sup> *General Obligation Bonds: The Departments of Water Resources and Finance Should Do More to Improve Their Oversight of Bond Expenditures* (Report 2010-117, May 2011).

some projects under certain bond programs. Also, we noted that while Finance had begun conducting audits of bond expenditures related to the strategic growth plan, as of late April 2011 it had issued audit reports on only three state entities administering the general obligation bonds. Without these audits, Finance cannot be sure that expenditures are consistent with bond laws or that projects achieve the benefits or outcomes intended when they were originally awarded. Finally, we reported that Water Resources needs to strengthen its monitoring of project deliverables and its divisions need to ensure that grant recipients submit periodic progress reports and that final site visit results are documented. These concerns are not new, as we reported similar findings in our 2009 high risk audit.

***In addition to concerns over bond accountability, we found that the State has shifted its focus away from improving California's infrastructure.***

In addition to the concerns over bond accountability, we found that the State has shifted its focus away from improving California's infrastructure. The 2008 update to the strategic growth plan indicated that in addition to the \$42.7 billion in approved infrastructure bonds from 2006, the State needs to make further investments in its infrastructure to maintain and improve California's quality of life and continue its economic growth. The updated plan proposed placing an additional \$48.1 billion in general obligation bonds on the ballot for voter approval in the 2008 and 2010 general elections. However, only \$9.95 billion of bonds related to infrastructure have been placed on the ballot, and these bonds were approved in the 2008 general election.

Additionally, the updated strategic growth plan did not anticipate the economic recession. According to Finance, given the economic recession, the focus of the governor and Legislature has shifted to the State's budget problems and deficit resolution. Finance further noted that until the more immediate fiscal issues are resolved, it is unlikely that decision makers will turn their attention back to infrastructure on a statewide basis. In addition, Finance stated that due to economic and fiscal changes since the 2008 update of the strategic growth plan, once the State is prepared to focus comprehensively on infrastructure, a complete review of programmatic needs and financing approach will need to occur. According to the Legislative Analyst's Office, with the ongoing budget problems, the State will continue to experience difficulty in addressing fundamental public sector goals, such as improving its aging infrastructure.

## Ensuring a Stable Supply of Electricity

We designated electricity as a high-risk issue in 2009 because California faced multiple challenges and problems related to energy production and consumption. Our current review found that although the State has made some progress in addressing these challenges, uncertainties still exist regarding utilities' ability to implement required retrofitting of certain power plants and the State's ability to meet its increased renewable energy target. Therefore, the State's supply of electricity continues to be a high-risk issue.

Although the uncertainty surrounding direct access—an option that enables customers to choose an electricity provider other than their default utility—could affect the ability of investor-owned utilities to rely upon a fairly consistent set of customers it will not likely affect the availability of electricity because the load remains the same. Direct access is currently available only to commercial customers. Further, the State has set limits on the electricity supplied by direct access providers. Residential customers do not have the right to direct access until the Legislature, by statute, lifts the suspension. In addition, the investor-owned utilities are required to work with the California Public Utilities Commission (CPUC) to ensure an adequate 10-year supply of electricity through a long-term procurement plan, which is revised every two years. This further mitigates the impact of direct access on the electricity supply for the State.

In our 2009 report on electricity as a high-risk issue, we expressed concerns that many aging power plants may need to either undergo expensive modification of their cooling systems or shut down. Specifically, power plants that use the once-through cooling method—the process of drawing in ocean water, circulating it through heat exchangers, and then discharging the water back into the ocean at a higher temperature—generated approximately 30 percent of the State's 2008 total electrical capacity. The once-through cooling method causes injury and death to marine life trapped on intake screens, drawn through the power plant's cooling system, and exposed to the discharged heated water. In May 2010, in an effort to minimize this environmental impact, the State Water Resources Control Board (Water Board) adopted a policy which was effective October 2010, requiring modification of power plants' cooling systems or other comparable measures to reduce mortality rate of marine life to an amount comparable to the effect of a 93 percent reduction in the existing water intake flow rate.

As of June 2011, 14 of the 17 fossil fuel plants using once-through cooling had submitted implementation plans and schedules to comply with the policy. Of the remaining three, one has been

*It is currently unknown whether implementation plans submitted by fossil fuel plants are adequate to address the new policy and what impact they will have on electricity production.*

repowered with an air cooling system and two have shut down. The State's two nuclear facilities will conduct special studies to address their unique issues. Although the owners of all 14 plants that continue to use the once-through cooling method have submitted plans, the Water Board and other state agencies and entities that are responsible for the regulation of these power plants are jointly in the process of reviewing these plans to ensure that they are realistic and will not cause disruption in the state's electrical power supply. Therefore, it is currently unknown whether these plans are adequate to address the new policy and what impact they will have on electricity production.

Further, the State has increased its target for renewable energy, and the uncertainty and difficulty surrounding the construction of infrastructure to transmit the renewable energy still exist. In April 2011 the governor signed into law a bill that set the State's target for renewable energy production at 33 percent of retail electricity sales in California by 2020. According to the CPUC, in 2010 the three large investor-owned utilities reported that they generated 17.9 percent of their electricity from renewable sources such as wind and solar. Although the State is making progress toward achieving the new renewable energy target, it needs to overcome several barriers to do so by 2020. Several regions in California have great potential for electricity generation from wind and solar power; however, the complex regulation of power plants and transmission poses difficulties with siting and constructing renewable electricity generators and transmission capacity in these regions. For example, depending on the type and location of the facility, various federal, state, and local entities can be involved in the facility's siting approval process. Additionally, the Independent System Operator, which operates the wholesale power system for approximately 80 percent of California, and the other five California balancing authorities must approve the interconnection of any new power-generating facility to their respective electric grids.

## Chapter 4

### EFFECTIVELY MANAGING THE STATE'S WORKFORCE

Given the uncertainties surrounding the efforts to modernize human resources management and the fact that many agencies are still in the process of developing or evaluating their succession plans, managing the State's workforce remains a high-risk issue. A large proportion of the State's workforce is nearing retirement age, particularly those in leadership positions. Because these individuals likely have institutional knowledge that is critical to running various state departments and programs, it is crucial for the State to have a plan to deal with these retirements. Moreover, although the State has made efforts to modernize and streamline its recruitment process for certain positions, its future efforts in this area are uncertain. Further, although some of the state departments we surveyed that provide critical services have developed workforce and succession plans, they are still in the process of implementing them.

#### State Workforce Retirements

The aging of the State's workforce, and an increase in retirements, could deprive the State of the unique perspectives and institutional knowledge possessed by individuals who are retiring. As a result, this issue remains on our list of high-risk issues.

As of June 2010 more than half of state employees in leadership roles and nearly 40 percent of rank-and-file employees were 50 years of age or older. In addition, state employees have been retiring at an increasing rate over the last three years, as Table 7 shows. For instance, in fiscal year 2007-08, 26 percent of state employees in leadership positions who were 60 years of age or older chose to retire. By fiscal year 2009-10 that retirement rate had increased to 35 percent.

**Table 7**  
**Percentage of Retirements by Age Group for State Civil Service Employees in Leadership Positions**

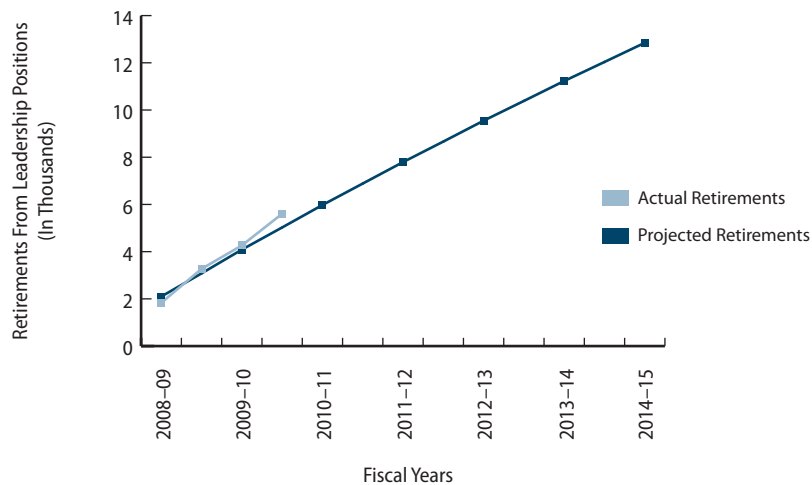
AGE GROUP	PERCENTAGE OF GROUP RETIRING IN FISCAL YEAR 2007-08	PERCENTAGE OF GROUP RETIRING IN FISCAL YEAR 2008-09	PERCENTAGE OF GROUP RETIRING IN FISCAL YEAR 2009-10
Under 50 years	0.01%	0.01%	0.00%
50 to 54 years	4.06	4.27	6.04
55 to 59 years	11.54	13.72	17.31
60 years and older	26.12	28.23	34.64

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

Note: Includes only state civil servants in full-time, permanent, or career executive assignment (CEA) positions. Excludes employees of the California State University, judicial branch, and legislative branch. Leadership positions include managerial, supervisory, and CEA positions.

In our 2009 high risk update,<sup>16</sup> we calculated the projected retirements through fiscal year 2014–15 for employees who were in leadership positions as of June 30, 2008. As Figure 5 shows, the actual retirements between July 2008 and December 2010 are relatively consistent with the retirements we projected for the same period. For example, we had projected that 13.4 percent of the employees in leadership positions as of June 30, 2008, would retire during fiscal year 2009–10. Our review of available retirement data found that 13.9 percent of those in leadership positions during fiscal years 2008–09 and 2009–10 retired during those two years. The projection estimated that, by the end of fiscal year 2014–15, nearly 12,847—or about 42 percent—of employees who were in leadership positions as of June 30, 2008, could potentially retire. Regardless of the precise timing of these retirements, planning is prudent to ensure continued delivery of state services.

**Figure 5**  
**Projected Retirements Compared to Actual Retirements Since**  
**Fiscal Year 2008–09**



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

Note: Projected retirements are based on information received from the Personnel Board and the Controller for the bureau's 2009 report, and include only those employees who were in leadership positions as of June 30, 2008. Actual retirements are based on data provided by the Personnel Board as of December 31, 2010, and include those employees who were in leadership positions at the time they retired.

<sup>16</sup> *High Risk: The California State Auditor's Updated Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2009-601, June 2009)

## Modernizing Hiring Procedures

Since our June 2009 report the Department of Personnel Administration (Personnel Administration) and the State Personnel Board (Personnel Board) have made additional progress in streamlining the State's hiring process for certain positions, but there are uncertainties surrounding the future of the efforts initiated through the Human Resources Modernization Project (HR-Mod). Therefore, this issue continues to be a high-risk area for the State.

HR-Mod's mission is to modernize and streamline the State's human resources programs. During its first year, HR-Mod established 15 ambitious objectives, with a plan to implement a large-scale integrated technology solution. However, the State's economic condition necessitated a shift toward implementing a smaller-scale, less costly version. Currently, HR-Mod has 10 objectives focusing on various areas, including workforce planning, simplifying job classifications, improving recruitment and hiring, coordinating statewide training, and increasing collaboration between state agencies. One of HR-Mod's accomplishments related to these objectives includes the implementation of 16 online exams. According to HR-Mod's executive project director, making exams available online has increased the pool of qualified candidates while eliminating duplication of effort, because multiple state entities can choose candidates from the eligibility lists created by the online exams.

Other accomplishments by HR-Mod include simplifying the State's complex civil service structure by abolishing or consolidating many civil service classifications and releasing competency models that identify the general competencies required for successful job performance in a specific occupational group. For example, HR-Mod has abolished 300 job classifications in an effort to allow state agencies to collaborate to jointly develop examinations and to cross-train employees, among other goals.

A recent proposal by the governor to reorganize the State's personnel agencies would, if enacted, place Personnel Administration and the Personnel Board into a new single department called the Department of Human Resources. It will take effect on July 1, 2012, unless the Legislature adopts a resolution through a majority vote that repeals the proposed reorganization plan. Therefore, it is uncertain which efforts initiated by HR-Mod will continue and what effects the reorganization will have on the State's efforts to manage its workforce.

*It is uncertain which efforts initiated by HR-Mod will continue and what effects the reorganization will have on the State's efforts to manage its workforce.*



### 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.

### Workforce and Succession Planning

Since our June 2009 high risk report, Personnel Administration and the Personnel Board have made additional efforts with regard to workforce planning. However, because many departments are still in the process of creating these plans, if they have begun to do so at all, it is not clear whether the plans will ensure a smooth succession and adequate staffing. Therefore, this issue continues to be a high-risk area for the State.

The Personnel Board and Personnel Administration have provided resources to state departments seeking to develop workforce and succession plans. Although there is no requirement to develop such plans, some departments have undertaken the effort to do so, using the model that the Personnel Board has created. Further, the Personnel Board has expanded the workforce planning courses that it offers to state department personnel. Personnel Administration has also developed a seven-step workforce planning model, as illustrated in the text box, to assist state entities in developing their workforce plans.

Further, the Personnel Board has expanded its two-day introductory course for workforce planning to a three-day course in which department staff learn all aspects of workforce and succession planning using their own

organization's data. The Personnel Board expects that attendees will leave with a workforce action plan and the knowledge and tools required to develop a workforce plan for their organization. In addition, the Personnel Board offers an advanced two-day course exploring the challenges of workforce planning, such as knowledge transfer strategies and communication skills. Also, Personnel Administration has held meetings in which staff from different state entities discuss strategies their agencies have used in implementing a workforce plan.

According to the results of a July 2008 survey by Personnel Administration, only 9 percent of the 104 state departments that responded to the survey indicated that they were implementing and evaluating their workforce plans, 32 percent were in the process of developing these plans, 35 percent had just begun developing their plans, and 24 percent had not yet started these efforts. Similarly, the results showed that 16 percent of the departments responding

to the survey were currently in the process of implementing and evaluating their succession plans, 32 percent were in the process of developing these plans, 30 percent had just begun, and the remaining 22 percent had not yet started these efforts. In our 2009 high risk report we noted that our review of five departments—California Emergency Management Agency (CalEMA), Department of Health Care Services (Health Care Services), Department of Public Health (Public Health), Department of Social Services (Social Services), and the California Department of Transportation (Caltrans)—found that except for Social Services the departments were in the early stages of workforce and succession planning.

In response to our current survey of these five departments for this update, CalEMA and Health Care Services noted that they have not yet completed their succession and workforce plans. Further, Caltrans is creating workforce plans for each occupational group, rather than the department as a whole. It noted that it is currently implementing and evaluating succession plans for the career executive assignment and maintenance occupational groups. Public Health and Social Services indicated that they have completed their succession and workforce plans and are in the process of implementing and evaluating these plans. However, because none of these plans have been implemented yet, the five departments cannot be assured that their plans will adequately address the concerns related to losing employees that possess the knowledge necessary to provide various services.

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## Chapter 5

### STRENGTHENING EMERGENCY PREPAREDNESS

The State's emergency preparedness continues to be an area of high risk. In previous reports we noted that the Department of Public Health (Public Health) and the California Emergency Management Agency (CalEMA) needed to address multiple issues to ensure that the State and local governments would be able to respond effectively in an emergency. During our current review of these issues we found that progress has been made in many of these areas; however, significant milestones and deadlines have yet to be accomplished.

#### Preparing for Public Health Emergencies

Public Health has incorporated emergency preparedness into its strategic plan, establishing key performance measures with specified deadlines. However, it has not achieved some of these objectives. In addition, uncertainty exists regarding continued federal funding and local health departments' budget challenges. Therefore, this area continues to warrant inclusion on the list of high-risk issues.

One objective of Public Health's strategic plan required that 90 percent of Public Health personnel complete Standardized Emergency Management System, National Incident Management System, and Joint Emergency Operations Center training by June 30, 2010. However, only 16 percent of Public Health's personnel actually completed training in all three areas. Public Health also encountered challenges in meeting its goal of ensuring that 43 local health departments received a Strategic National Stockpile<sup>17</sup> rating of at least 70 percent by the end of fiscal year 2008–09, with only 29 local health departments achieving this rating level. According to Public Health, the narrowly focused state and local efforts to respond to the 2009 influenza pandemic prevented planners from addressing broader public health preparedness issues. It further noted that although reduced staffing and budgets will hamper local health department planning efforts, through focused efforts at the state and local level Public Health has been able to ensure that more than 92 percent of Californians live in jurisdictions with a rating of 70 percent or better and that areas most at risk of a bioterrorism attack have an average rating of 84 percent. Also, Public Health

<sup>17</sup> The Strategic National Stockpile has large quantities of medicine and medical supplies to protect the public if there is a public health emergency severe enough to cause local supplies to run out. Each state has plans to receive and distribute medicine and medical supplies to local communities as quickly as possible.

*Public Health's deputy director of emergency preparedness continues to express concern about the uncertainty of federal grant levels and financial resources.*

increased the number of local health departments achieving the rating of 70 percent to 46 departments by the end of fiscal year 2009–10 and stated that its fiscal year 2010–11 target of 54 departments is achievable with current staffing and budgets.

Public Health's deputy director of emergency preparedness continues to express concern about the uncertainty of federal grant levels and financial resources. For the upcoming five-year Public Health Emergency Preparedness Grant, the U.S. Centers for Disease Control and Prevention (CDC) identified 15 public health target capabilities beginning in fiscal year 2011–12. These target capabilities are designed to provide guidance and recommendations for preparedness planning at the state and local levels, such as medical material management and distribution, and the sharing of emergency public information and warnings. States apply for funding each fiscal year to address selected capabilities and need to demonstrate that they meet that fiscal year's target capabilities to continue to receive funding. However, the deputy director noted that the federal budget contains unallocated cuts to both the U.S. Department of Health and Human Services and the CDC. Although Public Health is unsure of the impact of these cuts at this time, it anticipates that they will affect the public health emergency preparedness grants, which represented 58 percent of Public Health's budget related to emergency preparedness. The deputy director also noted that local health departments face overall budget challenges.

### **Establishing Priorities for the New CalEMA**

Since our 2009 high risk report, CalEMA has published its first strategic plan outlining its goals and objectives to protect the State during a disaster; however, our review indicated that the plan does not include specific performance measures, and some tasks have not yet started even though their planned completion dates have passed. In addition, to address the emergency preparedness issues from a 2007 gap analysis, which attempted to identify the shortfalls between what resources are available and what will be needed in a catastrophic event, CalEMA initiated the Metrics Project. The Metrics Project is targeted to result in specific deliverables, such as a common format and repository for data, including quality, capability, and location of specific resources. Although CalEMA has made some progress with the Metrics Project, it is not yet complete. Therefore, this area continues to be on our list of high-risk issues.

In 2009 CalEMA developed its first strategic plan covering the five-year period from 2010 to 2015. This plan included various goals and objectives that CalEMA believes will help it accomplish

its mission. However, the plan does not include any measures to gauge its success at meeting these goals and objectives. For example, one of its objectives is to enhance state and regional operational capabilities and readiness. To achieve this objective, the plan outlines activities such as ensuring that facilities including the warning center, regional emergency operations centers, and state operational center are modernized. However, there is no way to measure how successful CalEMA has been at achieving this goal. According to the chief of staff, CalEMA plans to develop measurements and benchmarks to quantify its progress toward various objectives.

Further, although CalEMA established completion dates for some of the activities related to various objectives, it has not started some of these activities, even though their planned completion dates have passed. For example, CalEMA's priorities and objectives task report indicates that a set of user training classes, with an intended completion date of June 30, 2010, has yet to start. CalEMA's audit chief noted that the report does not accurately reflect the progress CalEMA has made. Further, the director of policy and strategic initiatives indicated that CalEMA is reviewing and revising its strategic priorities, and plans to complete the update by June 30, 2011.

Additionally, CalEMA's Metrics Project has made some progress; however, it is not yet complete. The Metrics Project will enhance the ability to effectively prepare for and respond to disasters by developing a common format and repository for data, including quantity, capability, and location of specific resources. The project supports a common structure for inventory and assessment of emergency resources and capabilities. Currently, individual communities define, organize, and maintain the data, while CalEMA coordinates it through the Metrics Project. According to the project manager, CalEMA encountered challenges in collecting useful data from many diverse constituencies that had not previously understood the importance of capturing and maintaining the data and that are currently overtasked and underresourced. The Metrics Project coordinator noted that CalEMA is developing an online system that will allow local communities to readily gather, define, and display resource and capability data. It is currently working with several Bay Area communities and the California National Guard, on a pilot basis, to test this online system. CalEMA expects to launch this system statewide by July 2012.

*According to the project manager, CalEMA encountered challenges in collecting useful data from many diverse constituencies that had not previously understood the importance of capturing and maintaining the data and that are currently overtasked and underresourced.*

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## Chapter 6

### PROVIDING EFFECTIVE OVERSIGHT OF THE STATE'S INFORMATION TECHNOLOGY PROJECTS

The State's oversight of information technology (IT) projects continues to be an area of high risk. The Bureau of State Audits identified IT as a high-risk issue in 2007 because, despite efforts to establish statewide governance, the State had lacked strong IT oversight for many years and its prior governance models had limited authority and success. Our current review found that the California Technology Agency (Technology Agency)<sup>18</sup> has grown in size and responsibilities and has more authority as a control agency than its predecessors. However, with 70 state IT projects under development totaling more than \$7.8 billion and a relatively new project management system, IT project oversight remains on our list of high-risk issues.

#### IT Governance

The Technology Agency's governance authority over the State's IT systems—including its leadership in the areas of planning and policy development—has improved.

In our inaugural high risk report, we faulted the Technology Agency's predecessor for not having a clearly defined approval role or responsibilities. Many key IT functions, such as enterprise IT management and information security, data center and shared services, and IT procurement policy, are now the responsibility of the Technology Agency. The governor's 2009 reorganization plan integrated the Department of Technology Services, the Telecommunications Division within the Department of General Services (General Services), and the information security functions previously provided by the Office of Information Security and Privacy Protection into an expanded Technology Agency. Further, the reorganization plan transferred duties related to the State's procurement of IT from the Department of Finance (Finance), General Services, and the Department of Information Technology to the Technology Agency. Assembly Bill 2408, signed into law in February 2010, subsequently codified the governor's plan. The agency is now responsible for IT procurement policy and is required to review requests for proposals for state IT projects, giving it more authority than its predecessors.

<sup>18</sup> Governor's Reorganization No. 1 of 2009–10 Regular Session took effect on May 10, 2009. This plan was later codified by Assembly Bill 2408 of the 2009–10 Regular Session, which renamed the Office of the State Chief Information Officer (OCIO) as the California Technology Agency. Within this report we refer to the former OCIO as the Technology Agency.



***The Technology Agency rejects projects if they lack a business case, financial resources, or appropriate technology, and through this process the Technology Agency has rejected 132 IT projects as of March 2011.***

The Technology Agency continues to operate under a governance model in which the State, agencies, and departments maintain authority and accountability for IT at their respective government levels. At the statewide level the Technology Agency provides IT infrastructure and shared services, agencies provide program and policy direction and resource consolidation, and departments provide daily operations and support. Accordingly, the Technology Agency issues policy letters to state agencies and departments regarding various IT policies, standards, and procedures. According to the Technology Agency's chief technology officer, the reorganization facilitated IT transparency and communication among the various state offices charged with IT responsibilities.

In addition, the Technology Agency uses a statewide IT capital plan as a planning mechanism to ensure that the State's IT investments are aligned with business priorities in a manner consistent with the State's technology directives. According to the chief technology officer, the Technology Agency rejects projects if they lack a business case, financial resources, or appropriate technology, and through this process the Technology Agency has rejected 132 IT projects as of March 2011. Further, the Technology Agency and Finance entered into a memorandum of understanding in August 2009 that requires the Technology Agency to review budget change proposals related to IT systems and IT infrastructure. According to the chief technology officer, this review process allows the Technology Agency to monitor whether projects are on schedule and within budget, because departments need to submit a budget change proposal if their projects exceed approved contract values by 5 percent or more.

Finally, a concern we raised during our first report identifying statewide IT as a high-risk issue was that the Technology Agency's predecessor attempted to tackle too many challenges at once rather than establishing a set of priorities and taking on only the most important issues. Our current review found that the Technology Agency has a strategic plan in place that outlines the mission, vision, and philosophy of the State's IT program; describes the statewide IT goals, strategies, and high-level actions; and includes recent IT accomplishments and planned initiatives. The Technology Agency appears to track the dates and completion status for goals and action items outlined in its strategic plan. The Technology Agency included in its 2010 strategic plan performance report metrics that included baseline and fiscal year 2013–14 targets for key IT metrics to measure its progress against the strategic plan. The performance metrics were not included in its 2011 strategic plan because, according to the chief technology officer, the Technology Agency chose to include this information as part of another report it provides to the Legislature. The Technology

Agency provided documents showing that it continues to measure its progress toward the long-term targets it outlined in its 2010 strategic plan.

### IT Project Oversight

While the Technology Agency has strengthened its role in IT project oversight, due to the high cost of state IT projects and relatively new project management methodologies, its oversight of IT projects remains an area of high risk.

The Technology Agency continues to use the California Project Management Methodology (project methodology) as a guideline to manage state IT projects. State departments classify their IT projects as high complexity, medium complexity, or low complexity based on criteria established in the project methodology, some of which are described in the text box. As of May 18, 2011, the State had 70 IT projects under construction, with a total cost of more than \$7.8 billion.<sup>19</sup> Of these projects, 35 are designated high complexity with an estimated total cost of \$5.6 billion, 23 are medium complexity with an estimated total cost of \$151 million, and the remaining 11 are low complexity with an estimated total cost of \$38 million.

#### Examples of Criteria the California Technology Agency Uses to Determine Project Criticality

- The level of experience of the project manager and the project team.
- The level of financial risk to the state.
- The level of security within the information technology (IT) system.
- The volume of transactions anticipated for the IT system.

Sources: California Project Management Methodology, State Administrative Manual, and Statewide Information Management Manual.

The Technology Agency assigns part-time or full-time staff on some high-risk projects. According to the deputy director of the Program Management Office, for high complexity and critical projects the Technology Agency receives project information from multiple sources, such as project status reports from independent verification and validation and independent project oversight providers, as well as Technology Agency staff working on the projects. However, less oversight is performed on low- and medium-complexity projects. This appears reasonable for projects classified as low complexity because, as noted in the previous paragraph, these projects make up a small portion of state IT projects under construction and are, by definition, of low criticality.

According to the deputy director, it is the responsibility of the department project managers to report accurate and complete information to the Technology Agency regarding the status of

<sup>19</sup> The Technology Agency does not have the same oversight authority over projects undertaken by the Administrative Office of the Courts (AOC) and the federal court-appointed receiver for the California Department of Corrections and Rehabilitation (Corrections) that it has over other state entities. Nevertheless, Corrections has chosen to report project information on an exempt IT project to the Technology Agency, and the AOC provides periodic reports to the Technology Agency and an annual report to the Legislature that includes updates for one of its IT projects.

these projects. However, the Technology Agency appears to have appropriate measures in place to ensure that medium-complexity projects are completed on time and within budget. Specifically, the deputy director stated that the Technology Agency receives independent reports from the oversight providers of these projects and also receives information during meetings with the project staff and by reviewing IT project documents. Additionally, state agencies must submit to the Technology Agency a special project report when a project deviates by 10 percent or more from the most recently approved project cost, benefits, or schedule. Nevertheless, because its project management methodologies are relatively new and because state IT projects take time to complete, it is too early to assess the sufficiency of the Technology Agency's project oversight.

### Escalating Costs of Major IT Projects

Despite the progress made in the IT governance and oversight areas, the State continues to experience issues such as increasing costs and slipping timelines. The State's IT projects can be significant in scope and cost, and mismanagement of these projects can lead to substantial costs to taxpayers. Therefore, this area continues to be included on our list of issues presenting a high risk to the State.

We recently reviewed, are monitoring, or have received information on four large projects with a combined total cost of \$4.4 billion, that could have a major impact on state operations, and identified concerns related to project funding, increasing cost estimates, slipping deployment schedules, and inadequate project management. For instance, although the Financial Information System for California (FI\$Cal) recently received an exemption to the hiring freeze for certain positions, the project sponsor—a key leadership position responsible for, among other things, ensuring sustained buy-in at all levels and approving significant changes to the master project plan—was recently replaced when he was appointed as executive director of General Services in May 2011, and this change in leadership may pose a challenge for the project. FI\$Cal reported costs of \$44 million through May 2011. However, Finance has not updated the total projected cost of FI\$Cal since 2007, when it projected a total cost of \$1.6 billion. It anticipates updating the project's total projected cost and timeline in January 2012. Further, Finance presented funding options for FI\$Cal, which included funding the project costs in the budget as the costs are incurred, financing some contract costs through the vendor, or financing a portion of the project through bonds.

*Through May 2011 the State has spent \$44 million on its financial information system. However Finance has not updated the total projected cost of the system since 2007.*

Similarly, the 21<sup>st</sup> Century Project, designed to combine the State's various payroll, employment history, leave, position, and attendance data into one statewide system, has reported significant challenges with converting legacy data to the new system. It indicated that this has caused an unplanned delay affecting multiple activities required for successful implementation. As of June 2011 the project manager was unsure how this challenge would affect the total cost of this project, and she estimated that the deployment of this project will be delayed by as much as nine months. As of April 2011 the approved cost for the project was \$307.8 million and \$153.8 million had been spent. The Technology Agency has assigned oversight staff to both the FI\$Cal and 21<sup>st</sup> Century projects.

Corrections' Strategic Offender Management System (SOMS) is a large IT project that is not under the oversight of the Technology Agency. Corrections maintains responsibility for the implementation of SOMS but is working with the federal court-appointed health care receiver (receiver) who became involved in SOMS, in part, to expedite the procurement process for Corrections. The receiver filed, on behalf of Corrections, a request to the federal court to waive state contracting statutes, regulations, and procedures for SOMS, which was approved by the court. The waiver exempted SOMS from the State's IT oversight. However, Corrections has chosen to report project information to the Technology Agency. Corrections reported significant variances in the project's schedule, milestones, deliverables, and costs in its March 2011 status report to the Technology Agency. According to the SOMS project director, these variances existed because Corrections had not updated the project scope, cost, and timeline since 2006. Information provided by the project director indicates that SOMS is scheduled for completion in October 2014 and will cost \$500 million—two years later and \$84 million more than we reported in our June 2009 high risk review. Corrections attributes these increases to the lack of timely state budgets for the past two fiscal years, mandatory furloughs, and changes in the programs that the SOMS project supports. Corrections noted it is exploring several budget alternatives, as well as evaluating the impact of Assembly Bill 109, discussed in Chapter 2, before it updates its project scope, cost, and timeline. According to its status report to the Technology Agency, the project has incurred costs of \$142 million through May 31, 2011. Although the Technology Agency has no authority over SOMS, Corrections nonetheless provides status updates to the Technology Agency, and the Technology Agency has a staff person assigned to monitor and report on the SOMS project.

The Technology Agency also does not have the same oversight authority over the case management system being developed by the AOC that it does over other State IT projects. The AOC is responsible for managing the development of the most recent

***SOMS is scheduled for completion in October 2014 and will cost \$500 million—two years later and \$84 million more than we reported in our June 2009 high risk review.***

***We also found that the AOC's cost estimate for the system grew from \$260 million in 2004 to \$1.9 billion in 2010. Further, over the same period, complete deployment to the superior courts was postponed by seven years.***

version of a statewide court case management project called the Court Case Management System (CCMS). In February 2011 we reported that the AOC had experienced challenges with the project. Specifically, we reported that it had not adequately planned the statewide case management project since 2003, that it had failed to contract for adequate independent oversight, and that future funding for this project was uncertain. We also found that the AOC's cost estimate for the system grew from \$260 million in 2004 to \$1.9 billion in 2010. Further, over the same period, complete deployment to the superior courts was postponed by seven years. In our report we recommended, in part, that the AOC retain an independent consultant to review the system before deploying to three early-adopter courts.

According to the director of the AOC's Information Services Division, as of June 13, 2011, the AOC has awarded the contracts for independent code quality assessment and a rapid quality assessment of the CCMS software development project and resulting products and anticipates that the reviews will be completed by August 30, 2011. The AOC also hired a contractor to conduct a cost-benefit analysis of CCMS. However, our review of this analysis found that the data the AOC provided to the contractor excluded and understated certain costs, assumed certain benefits of CCMS that were questionable, and used a deployment model that included some unrealistic assumptions. Furthermore, the contractor acknowledged five critical factors that would affect CCMS's return on investment: delays in court deployment, the speed at which courts begin to realize benefits, budget overruns by the project, increases in court deployment costs, and the elimination of manual data entry of case files with justice partners. As of May 2011 the AOC estimated that it will complete CCMS by June 2017 and that the project will cost nearly \$2 billion. According to its May 2011 report to the Legislature, as of June 2010 CCMS had already cost the State \$454 million. The AOC anticipated that it will spend an additional \$93 million on the project in fiscal year 2010–11. However, on July 22, 2011, in reaction to State budget cuts, the Judicial Council reduced CCMS funding for fiscal year 2011–12 by \$56 million, which will result in a one-year delay in the deployment activities for the project to June 2018.

## Chapter 7

### INDIVIDUAL AGENCIES EXHIBITING HIGH-RISK CHARACTERISTICS

We have added the Department of Health Care Services (Health Care Services) and the Department of Public Health (Public Health) to our list of departments posing a high risk to the State because these two departments meet a number of the criteria we use to determine whether an agency presents a high risk. The Appendix describes the methodology and criteria we use to determine whether a state program, agency, or issue should be on the high-risk list. Both departments have been the subject of numerous audit requests by the Joint Legislative Audit Committee (audit committee) since they became separate entities from the former Department of Health Services (Health Services) in July 2007. In addition, we have made several recommendations to each department in our prior audits that remain outstanding one year after the recommendations were issued. Considering that some of the audit findings we have reported for these departments in the last few years can affect the health and welfare of the public, we have designated both departments as being a high risk. However, we have removed from our list of high-risk issues the split of Health Services into Health Care Services and Public Health. Our review found that both Health Care Services and Public Health have been measuring their progress toward the objectives in their strategic plans, and that their expenditures since the split have remained cost-neutral for certain cost centers compared to Health Services' expenditures after adjusting for inflation and state furloughs.

#### Health Care Services

We have designated Health Care Services as a department presenting a high risk to the State. Health Care Services provides a variety of services, such as ensuring access to comprehensive health services through the use of public and private resources, and emphasizing prevention-oriented health care measures that promote health and well being, and the effects of a failure could negatively affect the health and safety of Californians. Further, Health Care Services has been at the center of legislative branch attention. From January 2007 through February 2011, the audit committee had approved four audit requests involving Health Care Services—in essence one new audit every year. Among the issues the Bureau of State Audits (bureau) discovered as a result of these requests are that providers of durable medical equipment frequently

*As of December 31, 2010, Health Care Services had not fully implemented 11 recommendations dating back a year or more.*

overcharged Medi-Cal<sup>20</sup> and that Health Care Services needed to streamline Medi-Cal treatment authorizations and respond to authorization requests within the legal time limits.<sup>21</sup>

Finally, Health Care Services has a number of unresolved recommendations from previous audits. Specifically, as of December 31, 2010, Health Care Services had not fully implemented 11 recommendations dating back a year or more. Of these recommendations, three have a direct impact on public health and safety. For example, in August 2005 the bureau issued a report reviewing Health Services' administration of the Medi-Cal Administrative Activities Program<sup>22</sup> and recommended that the department require the local administrating entities to prepare annual reports that include participation statistics, outreach efforts and results, and other performance measures to assess the impact on the program recipients. Health Care Services, which now administers Medi-Cal has yet to implement this recommendation.

## Public Health

We have designated Public Health as a department posing a high risk to the State. We found that because of the services Public Health provides, such as preventing disease, disability, and premature death, and preparing for, and responding to public health emergencies, the effects of a failure at the department could have an adverse impact on the health and safety of Californians. Further, Public Health has also drawn the legislative branch's attention. From January 2007 through February 2011, the audit committee has approved five audit requests involving Public Health—an average of one new audit every ten months. Among the issues the bureau discovered as a result of these requests are that the department faces significant fiscal challenges and lacks transparency in its administration of the Every Woman Counts program,<sup>23</sup> that it must improve its oversight to better protect the public from low-level radioactive waste,<sup>24</sup> and that it reported inaccurate

<sup>20</sup> *Department of Health Care Services: Although Notified of Changes in Billing Requirements, Providers of Durable Medical Equipment Frequently Overcharged Medi-Cal* (Report 2007-122, June 2008).

<sup>21</sup> *Department of Health Care Services: It Needs to Streamline Medi-Cal Treatment Authorizations and Respond to Authorization Requests Within Legal Time Limits* (Report 2009-112, May 2010).

<sup>22</sup> *Department of Health Services: Participation in the School-Based Medi-Cal Administrative Activities Program Has Increased, but School Districts Are Still Losing Millions Each Year in Federal Reimbursements* (Report 2004-125, August 2005).

<sup>23</sup> *Department of Public Health: It Faces Significant Fiscal Challenges and Lacks Transparency in Its Administration of the Every Woman Counts Program* (Report 2010-103R, July 2010).

<sup>24</sup> *Low-Level Radioactive Waste: The State Has Limited Information That Hampers Its Ability to Assess the Need for a Disposal Facility and Must Improve Its Oversight to Better Protect the Public* (Report 2007-114, June 2008).

financial information—an overstatement of \$9.9 million as of June 30, 2009—in its management of the State and Federal Health Facilities Citation Penalties accounts.<sup>25</sup>

Finally, Public Health has a number of unresolved recommendations from previous audits. In fact, Public Health still had not fully implemented 20 recommendations dating back a year or more. Of these recommendations, 15 had a direct impact on public health and safety. For example, in September 2008 the bureau released a report regarding Public Health's Laboratory Field Services and recommended that it perform all its mandated oversight responsibilities for laboratories subject to its jurisdiction operating within and outside California including, but not limited to, inspecting licensed laboratories every two years, sanctioning laboratories as appropriate, and reviewing and investigating complaints and ensuring necessary resolution.<sup>26</sup> Public Health has yet to fully implement this recommendation.

***Public Health has a number of unresolved recommendations from previous audits—it had not fully implemented 20 recommendations dating back a year or more of which 15 had a direct impact on public health.***

### **The Reorganization of the Former Health Services**

In our 2009 high risk update, we identified that both departments developed strategic plans in 2008, as well as processes for measuring the overall success in achieving the goals of the strategic plans. Although each department was measuring its actions against its respective plan, we determined that more time was needed to prove these plans effective. Our most recent review of Health Care Services' implementation efforts for its strategic plan, and Public Health's strategic plan progress report and extension report found that Health Care Services and Public Health have met, or are on track to meeting, their goals. For example, Health Care Services indicated that it met one of its goals by establishing an online customer service portal to provide Medi-Cal beneficiaries with greater accessibility to information and resources concerning their options for enrolling in managed care. Similarly, Public Health noted that it is on track to accomplish one of its goals to increase the proportion of adults who are vaccinated annually against influenza.

In addition, as we noted in the 2009 high risk report, although the combined budget for the two new departments during fiscal year 2007–08 was higher than the fiscal year 2006–07 budget for Health Services, it is nearly impossible to determine which

<sup>25</sup> *Department of Public Health: It Reported Inaccurate Financial Information and Can Likely Increase Revenues for the State and Federal Health Facilities Citation Penalties Accounts* (Report 2010-108, June 2010).

<sup>26</sup> *Department of Public Health: Laboratory Field Services' Lack of Clinical Laboratory Oversight Places the Public at Risk* (Report 2007-040, September 2008).



costs would have increased even if the split had not taken place. For example, the State's share of Medi-Cal spending increased from \$13.8 billion in fiscal year 2006–07 under Health Services to \$14.9 billion in fiscal year 2009–10 under Health Care Services. However, it can be said that the increase would have been the same had Medi-Cal still been administered by Health Services. Although the same argument can be made for increases in some of the administrative costs, these costs are more likely to be affected by the split, especially those related to functions for which the two departments previously shared the same funding source. As a result, we compared administrative costs incurred since the split and charged to funds that the two departments shared with those from fiscal year 2006–07 before the split and charged to the same funds. Our review found that the amount, adjusted for inflation and the effect of furloughs, that Health Services would have spent was greater than the total amount spent separately by the two departments.

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, CPA  
State Auditor

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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 being 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 audit and investigative reports produced by 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 being at high risk not less than once every two years.
- To require state agencies identified as being 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 being at high risk.

### **Qualitative and Quantitative Factors**

In determining whether a state agency or statewide issue should be identified as being at high risk, we consider a number of qualitative and quantitative factors. Although we consider many qualitative factors, we focus in particular 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 also consider 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 either to take corrective action on substantiated complaints and report to us what action is taken or, if no action is taken, to indicate 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 as to how committed agencies are to 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 a state agency or statewide issue as being at high risk, 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 being 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