

Report 2017-601

# High Risk

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

COMMITMENT

INTEGRITY

LEADERSHIP





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January 18, 2018

2017-601

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

Dear Governor and Legislative Leaders:

As required by Chapter 251, Statutes of 2004, the California State Auditor presents this audit report concerning 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 believe that the State continues to face nine high-risk issues including aging and deteriorating water infrastructure, information technology oversight, access and affordability in higher education, and workforce and succession planning. We also believe that four state agencies continue to meet our criteria for high risk: California Department of Corrections and Rehabilitation, Covered California, California Department of Health Care Services, and the California Department of Public Health. Finally, we removed electricity infrastructure and the State's budget from our high risk list because of the steps that responsible state agencies have taken to address the risks.

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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# INTRODUCTION

## Background

State law authorizes the California State Auditor (State Auditor) to develop a state high risk program and to issue reports with recommendations for improving state agencies<sup>1</sup> and addressing statewide issues it identifies as high-risk. State law also authorizes the State Auditor to require the responsible state agencies to report periodically on the status of their implementation of our recommendations. In accordance with this statutory authority, the State Auditor adopted regulations in 2016 that further define our state high risk program. As outlined below, these regulations provide the criteria we used in determining the state high risk list we present in this report. According to the criteria, a state agency is responsible for a statewide issue if it is responsible for a portion of the issue or could be tasked with resolving a portion of the issue.

## Criteria for Determining Whether a State Agency or Statewide Issue Merits Designation as High-Risk

High-risk agencies and issues include not only those that are particularly vulnerable to fraud, waste, abuse, and mismanagement but also those that have major challenges associated with their economy, efficiency, or effectiveness. In addition, all four of the following conditions must be present for the State Auditor to designate an agency or issue as *high-risk*:

- The potential waste, fraud, abuse, mismanagement, or impaired economy, efficiency, or effectiveness may result in serious detriment to the State or its residents.
- The likelihood of this serious detriment is great enough to present a substantial risk to the State or its residents.
- The agency is not taking adequate corrective actions to prevent the substantial risk of serious detriment to the State or its residents.
- The substantial risk of serious detriment to the State or its residents may be significantly reduced by our performance of an audit and issuance of recommendations that are implemented to control or eliminate the causes of risk.

<sup>1</sup> The term *state agencies* encompasses every state office, officer, department, division, board, and commission.

For both state agencies and statewide issues, we consider a number of factors in determining the substantiality of risk, including whether the risks are already causing detriment to the State or its residents, whether those risks are escalating, and whether changes in circumstances are likely to cause detriment. We also assess different factors to determine whether the risks will result in serious detriment, such as loss of life, injury, or reduction in residents' overall health or safety; impairment of the delivery of government services; significant reduction of overall effectiveness or efficiency of state government programs; and impingement of citizens' rights. Finally, we evaluate whether the agency has taken adequate measures to correct previously identified deficiencies or whether the State has taken measures to reduce the risks posed by the statewide issues. In all cases, our professional staff make the final determination of risk level based on their independent and objective judgment. Appendix A beginning on page 69 further describes the factors we consider in making this determination. It also outlines the factors we consider when evaluating whether to remove an issue or agency from our high risk list.

### State High Risk Reports

Government Code section 8546.5 authorizes the State Auditor 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 that provided an initial list of high-risk issues and agencies, and we issued update reports on the status of those issues and agencies, as well as any additions, in June 2009, August 2011, and September 2013.

Since our September 2013 report, *High Risk: The California State Auditor's Updated Assessment of High-Risk Issues the State and Selected State Agencies Face*, Report 2013-601 (September 2013 report), we have continued to evaluate issues facing the State for inclusion on our high risk list. For example, in December 2013, we issued a separate report, *New High Risk Issue: Providing a High Quality and Affordable Public Education Presents Significant Challenges*, Report 2013-604 (December 2013 report), in which we designated kindergarten through 12th grade (K-12) education as high-risk because of significant policy changes, including the State's implementation of the local control funding formula (LCFF) and common core state standards. In that report, we also highlighted the impact that rising tuition costs and budget constraints had on residents' access to California's public universities. In 2015 we released several individual high risk update reports on a number of issues and agencies, such as the California Department of Public Health (Public Health), public safety realignment and the California Department of Corrections and Rehabilitation (Corrections), and oversight of the State's information technology (IT) by the California Department of Technology (Technology Department).



To update our analysis of high-risk issues and entities, we interviewed knowledgeable staff at the responsible agencies to gain their perspectives on the extent of the risks the State faces. We also reviewed any efforts underway that the staff at the agencies identified as mitigating those risks. In addition, we reviewed reports and other documentation relevant to the issues.

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# CHAPTER 1

## Infrastructure Modernization and Improvement

HIGH-RISK ISSUE	RESPONSIBLE AGENCY
<b>TRANSPORTATION INFRASTRUCTURE</b>	
It is still too early to assess the efforts of CalTrans and the Transportation Commission to ensure efficient and effective use of increased transportation funds.	<ul style="list-style-type: none"> <li>• California Department of Transportation (CalTrans)</li> <li>• California Transportation Commission (Transportation Commission)</li> </ul>
<b>WATER INFRASTRUCTURE</b>	
Many California dams are aging and require major repairs. Although the State has recently made efforts to improve dam safety and increase oversight, implementation of these efforts is still underway.	Department of Water Resources (Water Resources)
The California Waterfix project (Waterfix), intended to address environmental and water supply reliability issues, is still ongoing and requires approval by several regulatory and permitting agencies to move forward.	
<b>ELECTRICITY INFRASTRUCTURE</b> <i>(no longer a high-risk issue)</i>	
The State is ahead of schedule in meeting renewable energy targets, and the early retirement and modification of aging power plants have contributed to the stability of the State's power supply.	<ul style="list-style-type: none"> <li>• State Water Resources Control Board</li> <li>• California Public Utilities Commission (Utilities Commission)</li> <li>• California Energy Commission</li> <li>• California Independent System Operator (System Operator)</li> </ul>

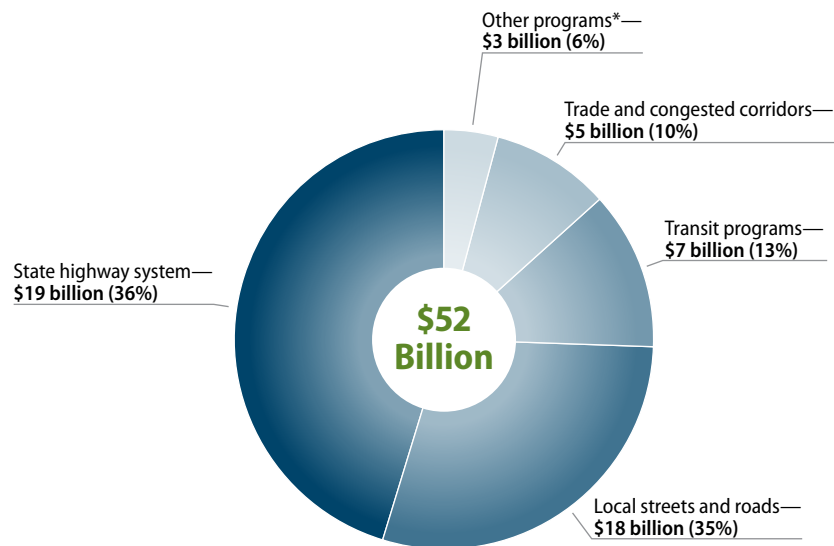
### It Is Too Early to Assess the State's Efforts to Ensure the Efficient and Effective Use of Increased Transportation Funds

Our September 2013 report highlighted the deteriorating conditions of the State's transportation system caused by insufficient funding and deferred maintenance. Two years later, Caltrans identified in its *2015 State of the Pavement Report* that 16 percent of the state highway system (state highways) was in poor condition. By 2017 the State estimated that it faced a \$137 billion funding shortfall for transportation over the next 10 years—\$59 billion of that amount is needed to adequately maintain the existing state highways and \$78 billion is needed to maintain existing local streets and roads.

To address this shortfall, the Legislature enacted the Road Repair and Accountability Act of 2017, Chapter 5, Statutes of 2017 (Road Repair Act), which will provide a significant, stable, and ongoing increase in state and local transportation funding. Although the Road Repair Act will not fully address the State's transportation funding shortfall, it will generate an estimated \$52 billion in revenue over the next 10 years through increases in gasoline and diesel taxes and in vehicle registration fees.

As Figure 1 shows, the Road Repair Act allocates funds among different state and local transportation programs. The largest share of these funds—\$19 billion—are to be used primarily for the maintenance and rehabilitation of state highways. Figure 2 shows that by fiscal year 2026–27, the vast majority of the State’s roads will be in good or fair condition as a result of this increased funding if the State meets the intent of the Road Repair Act.

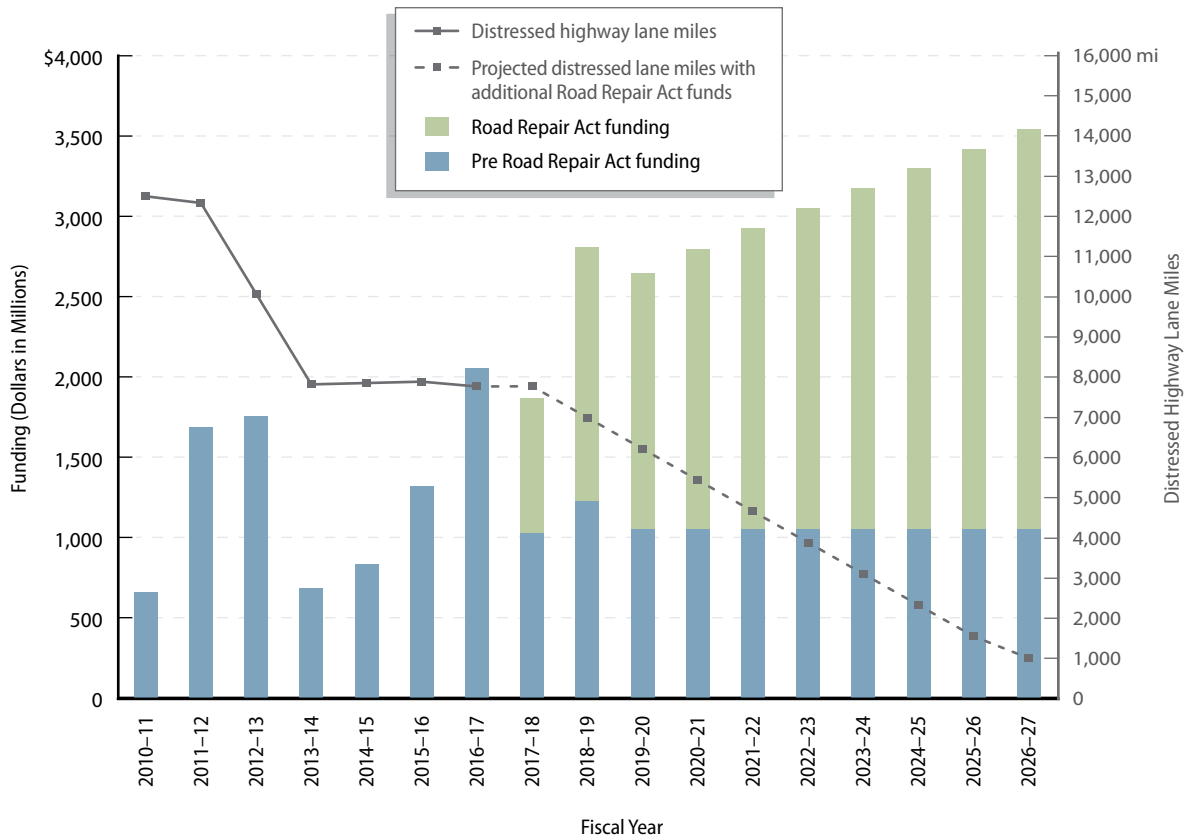
**Figure 1**  
An Estimated \$52 Billion in Revenue From the Road Repair Act Will Address State and Local Transportation Needs in the Next 10 Years



Source: California State Auditor’s analysis of the Road Repair Act.

\* *Other programs* include the Active Transportation Program for projects benefiting bicyclists and pedestrians, local planning grants, parks programs, off-highway vehicle programs, boating programs, the interregional share of the State Transportation Improvement Program, freeway service patrols, and transportation research at the University of California and the California State University.

**Figure 2**  
The Road Repair Act Aims to Reduce Distressed State Highways by Investing in Maintenance and Repair



Sources: Caltrans' 2015 State of the Pavement Report, estimated annual funding for state highways, and distressed highway lane miles target for fiscal year 2026-27 from the Road Repair Act.

Note: Distressed highway lane miles are defined as lane miles requiring corrective maintenance or major rehabilitation.

**The Legislature intends for Caltrans to meet the following five performance outcomes by the end of 2027 using Road Repair Act funds:**

1. At least 98 percent of state highway pavement is in good or fair condition.
2. At least a 90 percent level of service is achieved for maintenance of potholes, breaks, and cracks.
3. At least 90 percent of culverts are in good or fair condition.
4. At least 90 percent of transportation management system units, such as traffic signals, freeway ramp meters, and roadway weather information systems, are in good condition.
5. At least an additional 500 bridges are fixed.

Source: Road Repair Act.

Even though the increased funding represents a significant step toward rehabilitating the aging transportation infrastructure, challenges remain in ensuring that the State uses these funds to achieve the desired outcomes. For example, the Legislature has expressed its intent that Caltrans use the funding from the Road Repair Act to accomplish five specific measures of long-term performance (see text box). However, the Legislative Analyst's Office (Legislative Analyst) expressed concern that the Road Repair Act does not include specific mechanisms for holding Caltrans accountable for achieving these outcomes, does not set interim benchmarks against which to measure progress, and does not explicitly determine how to allocate money between highway maintenance and rehabilitation programs.

Acknowledging that accountability for expenditure of Road Repair Act funds is critical, the Legislature established certain oversight mechanisms. The

California State Transportation Agency (Transportation Agency) maintains that these oversight mechanisms do provide adequate accountability. However, because some of these mechanisms are still in their early planning stages, we cannot yet assess their sufficiency. For example, the Road Repair Act created a new inspector general for Caltrans, who will be responsible for ensuring that Caltrans and its contractors spend funding efficiently, economically, and in compliance with state and federal requirements. In October 2017 the Governor appointed a new inspector general; however, key questions remain unanswered, such as how the inspector general will select audits and investigations to perform.

The Road Repair Act also requires the Transportation Commission to implement guidelines to ensure the efficient use of Road Repair Act funds. In June 2017, the Transportation Commission adopted guidelines for two programs funded by the Road Repair Act: the State Highway Operation and Protection Program (SHOPP), which provides funding for major repair, safety, and operational improvements of the state highways; and the Active Transportation Program, a smaller program that funds bicycling and pedestrian improvement projects. In December 2017, the Transportation Commission adopted guidelines for the remaining Road Repair Act programs, and it estimates that it will identify the specific projects to receive funding by May 2018.

The Road Repair Act also requires Caltrans to develop, and the Transportation Commission to approve, a Transportation Asset Management Plan (TAMP), including targets for 2027. In June 2017, the Transportation Commission adopted guidelines for developing

the TAMP, which will inform and guide the project selection process for SHOPP. In October 2017, the Transportation Commission also began working with Caltrans to establish interim benchmarks for demonstrating progress towards the 2027 targets. Finally, the Road Repair Act requires Caltrans to regularly report to the Transportation Commission on the use of Road Repair Act funds and on its progress toward meeting the 2027 targets. Although these actions and plans demonstrate a strong commitment to ensure the effective and efficient use of Road Repair Act funds, many of these efforts are still in the early stages and will not have a positive effect on the State's transportation system for some years. Consequently, we continue to designate transportation infrastructure as high risk.

### **Water Infrastructure Remains a High-Risk Issue Because Most Flood Control Structures Are Aging and Deteriorating and Because Water Supply Issues Persist**

The State's flood control structures, like the highway system, are aging and deteriorating. Following a five-year drought, California experienced exceptional levels of precipitation in the winter of 2016–17 caused by a series of land-falling atmospheric rivers that caused flooding throughout the State and exposed vulnerabilities in the flood control infrastructure.<sup>2</sup> Furthermore, the reliability of water supply from the Sacramento-San Joaquin Delta (Delta) continues to be an issue as the WaterFix has not yet provided a solution.

#### ***The Need for Improved Flood Protection Is Critical***

Aging flood protection structures potentially endanger California's residents and economy. Although the state budget for fiscal year 2017–18 includes more than \$110 million for flood control projects and the Governor intends to invest more than \$400 million in the near future for flood prevention, these investments are a very small part of the amount that state and local agencies need to invest in upgrading that infrastructure. According to the Public Policy Institute of California, to manage future urban and coastal flooding, the State will need to invest a minimum of \$34 billion to improve levees, coastal defenses, urban stormwater systems, and dams.

The Oroville Dam crisis offers a tangible example of the risk that aging infrastructure presents to the safety and well-being of residents. In early 2017, after multiple storms, a large hole broke

<sup>2</sup> According to the National Oceanic and Atmospheric Administration, atmospheric rivers are narrow regions in the atmosphere that transport much of the moisture from the tropics to northern latitudes. Atmospheric rivers are part of the Earth's ocean water cycle and are tied closely to both water supply and flood risks.

***Major dams in the State have a median construction date of 1955, and many of these aging dams could pose high or extremely high hazard potential.***

open in the main spillway. Dam operators decreased the outflow to minimize the damage, but with the heavy rain and quickly rising water levels on Lake Oroville, the reservoir filled and water crested over the emergency spillway for the first time in the dam's history. The runoff caused the upper portion of the hillside below the emergency spillway to erode rapidly, and county officials ordered the evacuation of approximately 180,000 downstream residents until the risk of flooding could be reduced.

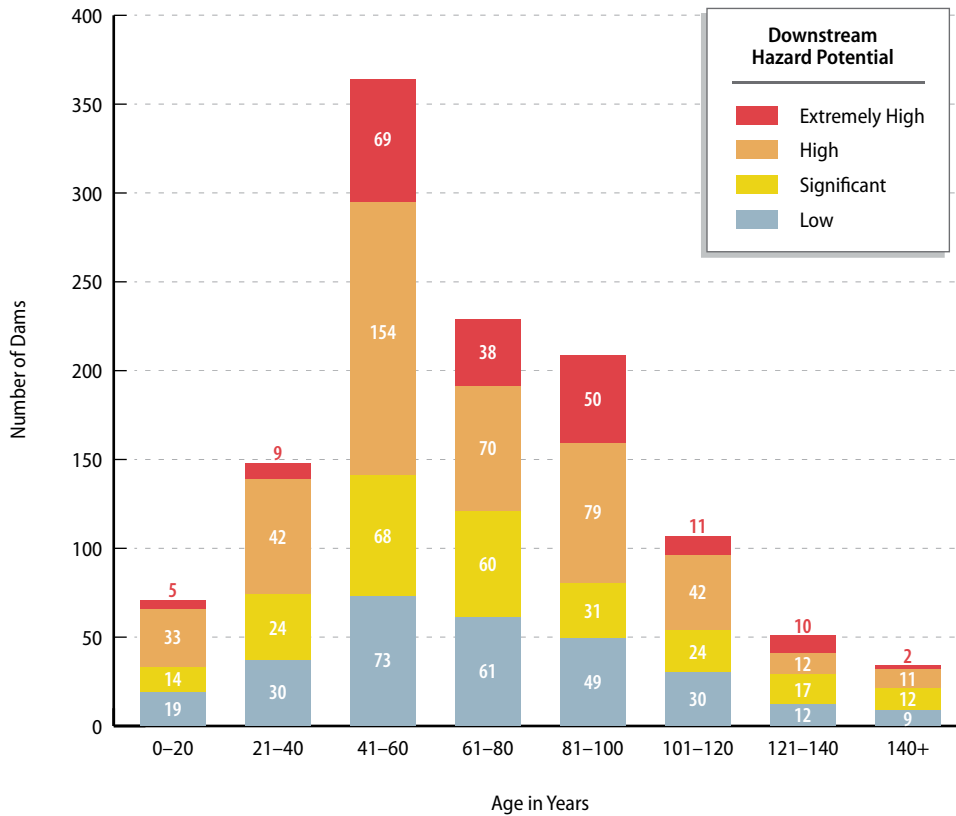
Constructed in 1968, the Oroville Dam spillway's advanced age is not an outlier; most of the major dams in the State, with a median construction date of 1955, are even older than the Oroville Dam, and many of these aging dams could pose high or extremely high hazard potential, as Figure 3 demonstrates. Dams classified as having *high or extremely high downstream hazard potential* are those whose failure would result in potential loss of life, economic loss, and environmental damage.<sup>3</sup> Further, according to Water Resources' Division of Safety of Dams (dams safety division), some of these dams were built using construction techniques that, if not remediated, might leave them vulnerable to full or partial failure in the event of a major earthquake. Water Resources indicated that many of these dams have been or will be repaired.

Data from the dams safety division show that, as of August 2017, 98 of the 1,249 dams throughout California are in less-than-satisfactory condition due to seismic, structural, and other deficiencies. As Figure 4 on page 12 indicates, many of the dams in less-than-satisfactory condition are near urban areas in the Bay Area, Southern California, and the Central Valley and, as a result, pose an extremely high downstream hazard potential. The chief of the dams safety division (division chief) explained that when dams are in less-than-satisfactory condition, her division prioritizes the most important issues based on risk and directs dam owners to provide a plan for remediation. She further explained that if an issue presents a significant and immediate dam safety concern, the dams safety division places a restriction on the dam, which requires the dam owner to operate at a lower lake level to reduce risk until the deficiencies are corrected. Data from the dams safety division show that it has placed restrictions on 39 percent of the dams in the State that are in less-than-satisfactory condition. According to the division chief, in some cases, the dams safety division may place a restriction on a dam as an enforcement mechanism to induce the dam owner to respond to the division's directives for timely repair. In extreme cases, the dams safety division can impose criminal penalties on dam owners.

<sup>3</sup> Downstream hazard potential does not relate to the age or condition of the dam itself, but rather the impact a failure of the dam would have.



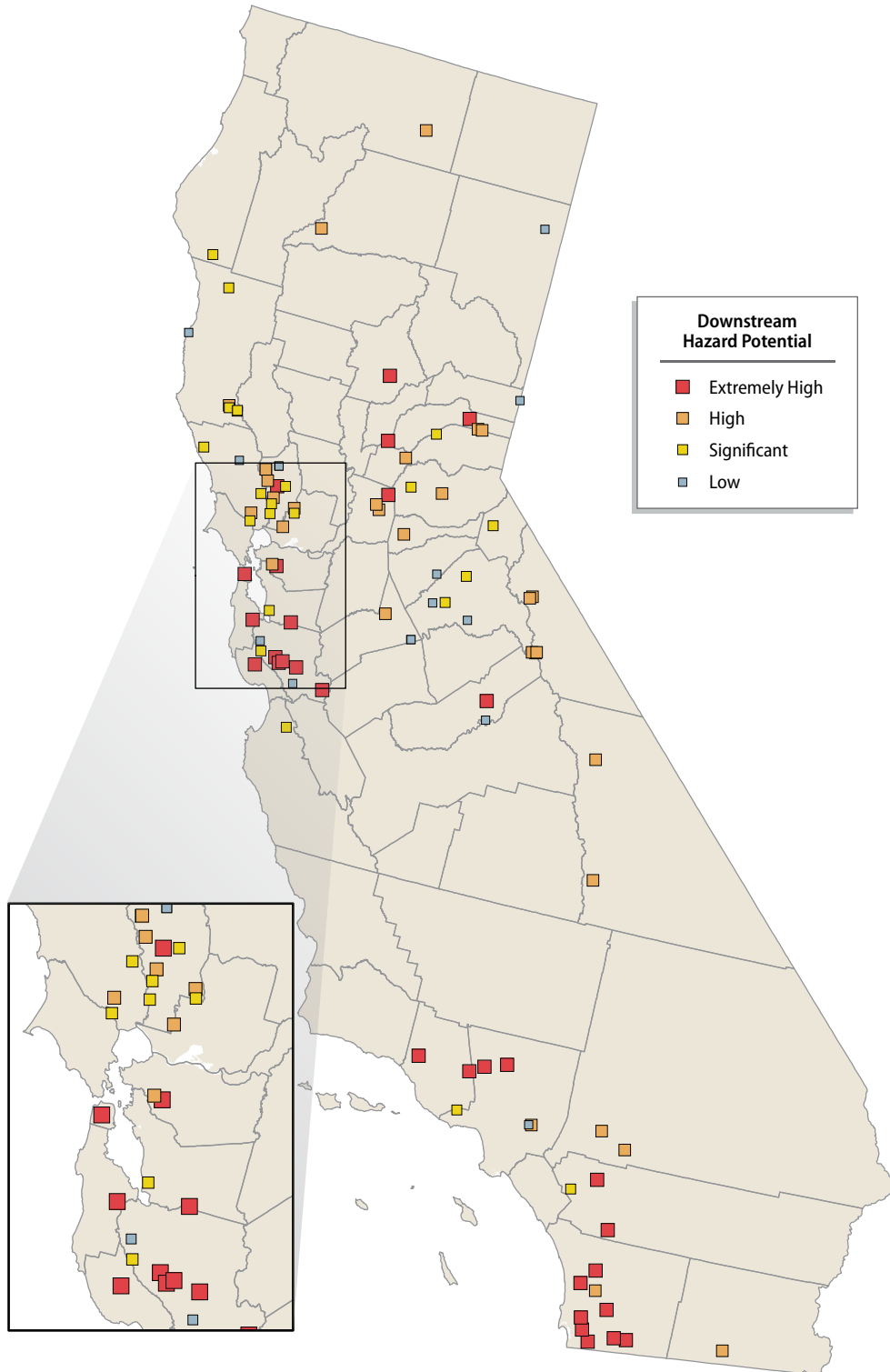
**Figure 3**  
 California's Major Dams Are Aging and Most High-Hazard Dams Are More Than 40 Years Old



Source: California State Auditor's analysis of data from Water Resources' dams safety division.

In recognition of these recent issues, the State has made efforts to improve dam safety. For example, the State's recent budget provides increased funding and authority for Water Resources to improve dam safety and enhance flood protection. It also requires that by 2021 all dams—except those with low hazard potential—must submit emergency action plans and make those plans publicly available. An emergency action plan is a formal document that identifies potential emergency scenarios at a dam and specifies the planned actions to be followed by local officials and emergency responders to minimize property damage and loss of life should one of the scenarios occur. Although some owners do voluntarily submit emergency action plans, the division chief noted that many of these plans are missing information and may not be reliable. Moreover, according to the National Inventory of Dams, nearly 300 California dams with high hazard potential do not have emergency action plans. Although the State has the authority to require and approve such plans by 2021, it has not yet begun to review or evaluate the usefulness of the plans submitted under the new state requirement.

**Figure 4**  
Dams in Less-Than-Satisfactory Condition With High or Extremely High Hazard Potential Are Common Throughout the State



Source: California State Auditor's analysis of data from Water Resources' dams safety division.

The Oroville Dam spillway crisis has also led the dams safety division to improve its dam supervision. The dams safety division inspects each dam annually to ensure that it is safe, performing as intended, and not developing problems as defined by industry standards. The dams safety division inspects 1,249 dams each year and, according to the division chief, engineers often inspect multiple dams each day. While frequent, these inspections are only visual inspections. The dams safety division performs more thorough studies of dam safety, or *reevaluations*, on dams at a higher risk of damage or failure. Also according to the division chief, the dams safety division is only able to complete one or two reevaluations a month, depending on workload and the complexity of the issues the dam presents. In the past decade, the dams safety division has focused reevaluations on structures that might fail as a result of an earthquake. According to the division chief, following the Oroville Dam spillway incident, the dams safety division is conducting more detailed evaluations of dam structures, focusing on spillways.

However, even these improved evaluations may not be adequate. Specifically, the Oroville Dam Spillway Incident Independent Forensic Team (forensic team), which Water Resources formed to investigate the causes of the Oroville spillway incident, believes that more comprehensive reviews of all dam components are needed to identify risks and manage safety. The forensic team released a memorandum in September 2017 that concluded that the existing physical inspection regime, while necessary, was insufficient and would not likely have uncovered the issues that led to the Oroville spillway incident. The forensic team recommended comprehensive, periodic reviews of the original design and construction for all dam components and noted that the team found no evidence of such a review ever having occurred of the Oroville Dam spillway. According to the division chief, the dams safety division agrees with the conclusions in the memorandum, but limited staffing resources and the lengthy period of time needed for comprehensive reviews may mean that the dams safety division still cannot examine all components of the dams it evaluates. Instead, the dams safety division will focus on the dams and dam components that pose the highest risk to the public.

Although the State is responsible for regulating and supervising the construction and repair of major dams, improvements to dams are ultimately the responsibility of their owners, who are generally not state or federal agencies. If, as a result of inspections or reevaluations, the dams safety division determines that a dam constitutes a danger to life or property, it may order corrective actions. However, according to the division chief, some dam owners do not have the resources to make timely and costly capital investments. As we previously discussed, 98 of the State's 1,249 dams have structural issues that threaten their safe use. If the owners do not have the resources to make needed repairs to these dams, California's residents and property may be at risk.

***The dams safety division will focus on the dams and dam components that pose the highest risk to the public.***

### ***Ensuring a Stable Water Supply Remains a Challenge***

At the heart of California's water supply issue is the Delta, a network of engineered channels and agricultural lowlands at the confluence of the Sacramento and San Joaquin rivers. The California State Water Project and the federal Central Valley Project export water from the southern Delta to more than 25 million people and 3 million acres of irrigated farmland in the Bay Area, the San Joaquin Valley, and Southern California. However, the reliability of this water supply continues to be a problem for the State.

In our September 2013 report, we described that the transfer of water from the northern part of the State through the Delta to farms and cities in Southern California was leading to environmental concerns, which in turn resulted in new environmental laws, regulations, and restrictions on water supplied from the Delta. Planning began in 2006 on the development of the Bay-Delta Conservation Plan (BDCP) to restore the Delta's ecosystem and improve the reliability of water supplies throughout the State. However, in the September 2013 report, we explained that the BDCP was still in the planning stage and that time of completion and funding challenges were to be expected. Shortly after the September 2013 report was released, concerns arose over the long implementation period of the BDCP, which led Water Resources and the U.S. Bureau of Reclamation to devise additional alternatives and in April 2015, WaterFix was announced as the preferred alternative to the BDCP. However, WaterFix is ongoing and has not yet provided a solution to the State's water supply issue.

In our October 2017 report, *Department of Water Resources: The Unexpected Complexity of the California WaterFix Project Has Resulted in Significant Cost Increases and Delays*, Report 2016-132 (October 2017 report), we reported that the WaterFix planning phase had experienced significant cost increases and schedule delays because of the scale and unexpected complexity of the project. Moreover, according to the October 2017 report, several regulatory and permitting processes were ongoing and had to be completed before construction of WaterFix could move forward, including hearings by the State Water Resources Control Board regarding water rights and water quality, which are expected to last until sometime in 2018.

### **Increases in Renewable Energy Production and the Early Retirement of Aging Power Plants Have Stabilized the State's Electricity Supply**

In our September 2013 report, we expressed concern that environmental circumstances and aging power plants could threaten the stability of the State's electricity supply. However, we also noted that the State had made progress toward increasing its

capacity for renewable energy generation and that power plant owners were taking steps to comply with the State Water Resources Control Board’s 2010 policy to reduce the environmental risks posed by their aging facilities. Our current evaluation indicates that these improving trends have continued.

Specifically, during the past four years, the State’s utilities have met the demand for electricity through a combination of traditional and renewable energy, while staying ahead of schedule in meeting the State’s renewable energy target requirements (see text box). Under state law, retail sellers and California’s publicly owned electric utilities must procure 33 percent of their electricity from renewable sources by the end of 2020, and our analysis of data obtained from the Utilities Commission found that the State is on track to meet and possibly surpass this goal. In addition, the California Energy Commission estimates that about 27 percent of California’s electricity retail sales in 2016 involved renewable energy generated from wind, solar, geothermal, biomass, small hydroelectric, and other sources. According to the California Energy Commission’s energy assessments division director (energy division director), utility plans suggest that the State will be able to meet the 50 percent target for 2030. However, pending legislation could increase the post-2020 goals, potentially requiring 52 percent renewable energy sources by 2027 and 60 percent by 2030.

**California’s Renewable Energy Targets**

YEAR	PERCENTAGE
2016	25%
2020	33
2024	45
2027	45
2030	50

Source: Public Utilities Code section 399.15.

The rapid increases in renewable energy production present some challenges, but the California Energy Commission, the Utilities Commission, and the System Operator are working on ways to address them. For example, the Utilities Commission established an energy storage goal for utilities by 2020 to help supply additional power during peak hours. Also, the System Operator participates in multistate networks that distribute production overages for additional efficiency in energy distribution and to avoid costly production shutdowns of renewable energy. Similarly, by encouraging utilities to set seasonal and time-of-day consumer pricing that follows the natural patterns of renewable electricity generation, the System Operator is supporting efforts to change electricity demand. According to the Utilities Commission’s energy division director, these new challenges do not present a threat to the provision of reliable electricity.

In addition, the State has retired some aging power plants and modified others ahead of mandated deadlines, thereby mitigating some of our concerns regarding the stability of the State’s power supply. According to a 2017 report by the Statewide Advisory Committee on Cooling Water Intake Structures (2017 advisory committee report), power plants are meeting the compliance expectations in the State Water Resources Control Board’s 2010 policy, and the resulting

environmental benefits have exceeded those described in the policy. For example, the 2010 policy sought to modify the cooling systems of aging power plants in order to reduce mortality rates of marine life. The 2017 advisory committee report stated that several power plants had achieved compliance in advance of their mandated deadlines and that the early retirement of some facilities had accelerated the expected environmental benefits. The report explained that the utilities only use the capacity of most of the remaining plants during a small percentage of the time, but this capacity helps serve demand during peak hours and during stressed operating conditions.

Because state agencies are meeting renewable electricity targets and complying with the State Water Resources Control Board's policies, the stable production and delivery of electricity no longer meets our high risk criteria. Given these positive trends, which the Utilities Commission forecasts will continue, we are removing the production and delivery of electricity from our high risk list but will continue to monitor these issues as regulations require.

## **Agency Comments**

### ***Transportation Infrastructure***

On behalf of the Transportation Commission and Caltrans, the Transportation Agency responded to our draft report and concurred that it is too early to fully assess the State's efforts to ensure efficient and effective use of Road Repair Act funds, but indicated that it believes it has taken or is taking steps to achieve this end. The Transportation Agency cited specific examples of those steps and provided additional perspective, most of which we added to our analysis.

### ***Water Infrastructure***

Water Resources responded to our draft report and agreed that statewide dam safety and water reliability are critically important. Water Resources provided clarification and additional perspective regarding the efforts it has taken to address aging infrastructure—particularly dam infrastructure—much of which we added to our analysis.

### ***Electricity Infrastructure***

The State Water Resources Control Board agrees with our discussion and conclusion that electricity is no longer a high-risk issue. Other responsible agencies did not provide written comments.

## CHAPTER 2

### Individual Agencies With High-Risk Characteristics

HIGH-RISK ISSUE	RESPONSIBLE AGENCY
<p>Covered California has only partially implemented our prior audit recommendation that it analyze the adequacy of its reserve levels, including identifying actions it could take if revenues fall short of projections.</p> <p>With the change in the federal administration, discussions and actions concerning repealing, replacing, or revising the Patient Protection and Affordable Care Act (Affordable Care Act) have been occurring, casting uncertainty on the future of Covered California and insurance exchanges for other states.</p>	Covered California
<p>Although the office of the federal court-appointed receiver (Receiver's Office) and Corrections continue to make progress on the remaining goals of the Receiver's turnaround plan concerning the prison health care system, until Corrections can demonstrate that it can adequately manage functions related to inmate medical care and until the Receiver's Office delegates complete authority back to Corrections, the prison health care system will continue to be a factor contributing to Corrections' designation as a high-risk agency.</p> <p>Without a fully-implemented succession management program in place to help ensure the availability and quality of future leaders, Corrections may struggle to find and retain the leaders it will need, another factor in Corrections' continuing designation as a high-risk agency.</p>	Corrections
<p>Health Care Services is still working to implement seven recommendations from our August 2013 report, <i>Mental Health Services Act: The State's Oversight Has Provided Little Assurance of the Act's Effectiveness, and Some Counties Can Improve Their Program Performance</i>, Report 2012-122 (August 2013 report). The circumstances prompting five of these recommendations could pose a substantial risk for reduced health and safety of the vulnerable population that relies on publicly funded mental health programs.</p> <p>Health Care Services has not verified some eligibility qualifications for Medi-Cal beneficiaries. As a result, Health Care Services could make inappropriate payments and be liable to the federal government for overpayments of federally funded aid.</p>	Department of Health Care Services (Health Care Services)
<p>Despite considerable progress towards implementation, Public Health has not implemented four of our audit recommendations that concern substantial risk of the loss of life, significant injury, or a broad reduction in residents' overall health or safety if the recommendations remain unimplemented. We continue to see it as a high-risk agency.</p>	Public Health

#### The Uncertainty of the Future of the Affordable Care Act Keeps Covered California a High-Risk Agency

Covered California is required to be self-supporting and its only source of revenue is based on the number of consumers it enrolls in health plans. Although the agency has made improvements towards ensuring its financial viability, Covered California's financial sustainability remains at high risk.

In our July 2013 report, *New High Risk Entity: Covered California Appears Ready to Operate California's First Statewide Health Insurance Exchange, but Critical Work and Some Concerns Remain*, Report 2013-602, we designated Covered California as high-risk because its future solvency remained uncertain. Subsequently in our February 2016 report, *High Risk—Covered California: It Must Ensure Its Financial Sustainability Moving Forward, and Its Use of Sole-Source Contracts Needs Improvement*, Report 2015-605 (February 2016 report), we noted our continuing concern regarding Covered California's financial sustainability and that it would remain on our high risk list. In that report, we made two recommendations related to Covered California's financial sustainability, one of which has not yet been fully implemented.

First, we recommended that Covered California continue to regularly review and update its enrollment projections as needed to help ensure its financial sustainability—a recommendation we determined it has fully implemented. As we concluded in our February 2016 report, Covered California is a relatively new agency with limited historical data that can inform its enrollment projections, creating a risk that enrollment and revenue will be different than expected. Covered California annually updates its enrollment forecasts, which it bases on expectations about future enrollment growth and its own enrollment history from data provided by experts. Covered California's budget documents include low, medium, and high enrollment forecasts and corresponding revenue projections that it updates annually. Based on our review of its enrollment forecasts for fiscal years 2013–14 through 2016–17, we found that actual enrollment has generally been higher than Covered California's medium enrollment forecasts, suggesting that its forecasting is conservative and reasonably accurate. We also found that Covered California continually updates its enrollment projections as needed. For example, in its proposed fiscal year 2017–18 budget, Covered California modeled alternate enrollment forecasts to reflect the uncertainty facing its enrollment and revenue outlook stemming from possible federal legislative or regulatory actions that could change key provisions of the Affordable Care Act.

In this proposed budget, Covered California acknowledged that depending on the types of changes to the Affordable Care Act that occur, the decline in enrollment could be dramatic but, from its financial perspective, the loss could be manageable. Specifically, Covered California plans to maintain reserves adequate to cover between nine and 12 months of operating costs. In fact, according to its proposed fiscal year 2017–18 budget, Covered California anticipates ending the fiscal year with more than \$289 million in reserves, the equivalent of about 11 months of operating costs.

***Covered California plans to maintain reserves adequate to cover between nine and 12 months of operating costs.***



In the event of a revenue shortfall, we also recommended in our February 2016 report that Covered California complete a formal analysis of the adequacy of its reserve level and update this analysis as needed in case it does not meet its revenue projections and needs to increase its funding or decrease its expenditures to maintain solvency. We recommended that this formal analysis identify the actions it would take in the event of a revenue shortfall. Subsequent to our February 2016 report, we designated the status of this recommendation as fully implemented based on an analysis from Covered California regarding the adequacy of its reserve level, which reported that in the event of decreased enrollment and therefore revenue, it could reduce contractual expenditures, among other actions, to maintain solvency. However, during this current assessment of high-risk agencies, we determined that Covered California had only partially implemented this recommendation.

Specifically, Covered California could not produce the underlying documentation that supports this analysis; instead, staff explained that the analysis is a basic plan for what costs it could cut in the event of decreased enrollment and that it had not yet finalized the listing of specific contracts that would be subject to cuts. However, we believe its finalization of this listing is critical. Although Covered California could increase revenues by increasing its charges for health plan premiums, it would not experience the financial impact of such an increase for nine to 18 months according to its proposed fiscal year 2017–18 budget. Without a formal analysis of its planned actions to reduce expenditures, including identifying specific contracts that it would eliminate, Covered California may not be able to react quickly to a significant decrease in enrollment to maintain its solvency. As a result, we do not believe Covered California has taken sufficient corrective action to fully address our recommendation.

Finally, within the current federal administration, there have been discussions and certain actions around repealing, replacing, or revising the Affordable Care Act, casting uncertainty on the future of Covered California and the insurance exchanges in other states. In its proposed fiscal year 2017–18 budget, Covered California acknowledges this uncertainty, explaining that it will closely monitor proposed program changes, remain nimble, and be ready to respond to changes as they occur. As an example, in an August 2017 document, *Covered California's Health Insurance Companies and Plan Rates for 2018* (plan rates report), Covered California explained certain actions it will take to keep the market stable and protect consumers from a potential change regarding cost-sharing reduction reimbursements, a key element of the Affordable Care Act. Specifically, the law requires health insurance companies to offer cost-sharing reductions to lower-income consumers, in the form of lower co-pays and deductibles, which help reduce out-of-pocket costs when consumers access the care they need. According to Covered California, nearly

***Without a formal analysis of its planned actions to reduce expenditures, including identifying specific contracts that it would eliminate, Covered California may not be able to react quickly to a significant decrease in enrollment to maintain its solvency.***

*The uncertainty surrounding other potential changes to the Affordable Care Act poses a significant threat to Covered California's financial sustainability and increases the risk of serious detriment to the State.*

half of its 1.4 million enrollees benefit from these cost-sharing reductions. In its plan rates report, Covered California explained that the federal government has only made month-to-month commitments to reimburse health plans for these required subsidies, and it has not committed to making those payments in 2018.

In fact, in October 2017, the federal administration announced its plans to end cost-sharing reduction reimbursements for 2018. In an October 2017 press release, Covered California stated that its health insurance companies will add a surcharge to certain health plan products in 2018 in the absence of a federal commitment to continue funding cost-sharing reduction reimbursements. Specifically, certain nonsubsidized consumers will face, on average, a 12.5 percent increase in their 2018 premiums to offset the discontinuation of those reimbursements. However, the press release referenced a Covered California analysis on the impact of the surcharge, which found that nearly 80 percent of subsidized consumers would either see no change in what they would pay for insurance in 2018 or would pay less than what they would have paid if there had been no surcharge. Although Covered California has taken steps to help stabilize the market, such as minimizing the number of consumers affected by a discontinuation of cost-sharing reduction payments, the uncertainty surrounding other potential changes to the Affordable Care Act poses a significant threat to Covered California's financial sustainability and increases the risk of serious detriment to the State. This significant uncertainty, coupled with Covered California needing to fully implement one of the recommendations from our February 2016 report, causes us to conclude that Covered California remains a high-risk state agency.

### **Although It Has Made Progress, Corrections Still Remains a High-Risk Agency**

In 2007 we designated Corrections as a high-risk state agency because of overcrowding in the state prisons, the status of the prison health care system, and Corrections' lack of consistent leadership. In our April 2015 report, *High Risk Update—Public Safety Realignment and the California Department of Corrections and Rehabilitation: The State Has Reduced Overcrowding in Its Prisons, but Its Inmate Health Care Is Still Under Federal Receivership*, Report 2015-609/2015-610 (April 2015 report), we found that Corrections had reported significant reductions to the state prison population and prison overcrowding was no longer a factor for its designation as a high-risk state agency. Our current review also finds continued improvements to the prison health care system and Corrections' leadership. As of April 2017, of the six goals established in the Receiver's Office's turnaround plan of action, only one remains outstanding and the Receiver's Office continues to delegate authority over more prisons back to Corrections. Similarly,

Corrections continues to make progress in reducing the number of vacant leadership positions and has begun developing a succession management program. However, until Corrections demonstrates that it can maintain the medical care system that the Receiver's Office has put in place and that it has fully implemented its planned succession management program, Corrections remains a high-risk agency.

### ***Plans for Transitioning the Prison Health Care System From Receivership Are Underway, but More Work Remains***

In 2006 the federal court ordered California's inmate health care system to remain in federal receivership until the court determines that the State has the will, capacity, and leadership to maintain a system that provides constitutionally adequate medical care to inmates. In March 2015 the federal court issued an order (the March 2015 Order) clarifying the terms and conditions for transitioning the State's prison medical care system back from the Receiver's Office. The March 2015 Order outlines the process for the gradual delegation of authority over headquarters' functions and prisons' medical care back to Corrections and vests the Receiver with the delegation decisions. The order followed the Receiver's Office reporting in February 2015 that it had made notable improvements to the inmate health care system and had already delegated three areas of operations back to Corrections. The Receiver Office's report in February 2017 also noted improvement. However, until Corrections can demonstrate that it is capable of maintaining the medical care systems that the Receiver's Office has put in place, the prison health care system will continue to contribute to Corrections' designation as a high-risk agency.

The Receiver's Office published a turnaround plan of action (turnaround plan) in 2008 to guide its efforts for bringing prison health care services within Corrections up to federal constitutional standards. The turnaround plan states that constitutionally adequate health care requires that inmates receive timely access to competent medical and clinical personnel who provide effective care that is informed by accurate patient records. Constitutionally adequate health care also requires that inmates have access to appropriate medical facilities, equipment, and processes as well as timely access to prescribed medications, treatment modalities, specialists, and appropriate levels of care. As shown in Table 1 on the following page, the Receiver's Office outlined six goals, which it characterized—along with the associated objectives and action items—as necessary for the health care program to reach constitutionally acceptable and sustainable levels.

In our April 2015 report, we noted that the Receiver's Office reported significant progress in achieving its goals, but critical areas needing improvement remained. Specifically, the Receiver's Office reported

that 43 of the 47 actions required to achieve these six goals were complete and that the other four were in process. During our current review, the Receiver's Office indicated that it had completed three of these actions, including implementing a quality assurance and continuous improvement program, and establishing medical support infrastructure. In regards to the one remaining required action, the Receiver's Office expects Corrections to achieve the goal of providing necessary clinical, administrative, and housing facilities by March 2020.

**Table 1**  
**Progress of Prison Health Care Services Toward Completing Actions and Achieving Goals Established in the Turnaround Plan of Action**

GOAL	TOTAL NUMBER OF REQUIRED ACTIONS	NUMBER OF ACTIONS COMPLETED	NUMBER OF INCOMPLETE ACTIONS	GOAL ACHIEVED
Ensure timely access to health care services	9	9	0	✓
Establish a prison medical program addressing the full continuum of health care services	9	9	0	✓
Recruit, train, and retain a professional-quality medical care workforce	6	6	0	✓
Implement a quality assurance and continuous improvement program	9	9	0	✓
Establish a medical support infrastructure	7	7	0	✓
Provide for necessary clinical, administrative, and housing facilities	7	6	1*	✗
	47	46	1	

Sources: California State Auditor's analysis of the tri-annual reports of the federal Receiver's turnaround plan of action for September 1, 2014, through April 2017.

✓ = Yes

✗ = No

\* According to the Receiver's Office, Corrections is responsible for implementing this required action.

The director of the office of communications and legislation for the Receiver's Office stated that although it considers the implementation of its quality assurance and continuous improvement program complete, the program requires ongoing measuring and tracking, and for Corrections to be successful in the future, it must use the tools the Receiver's Office has put in place to monitor quality assurance. In its tri-annual report on the progress in achieving its goals filed in February 2017, the Receiver's Office reported that it had completed a fourth learning session by the end of December 2016 focusing on full implementation of institution quality management systems as part of the quality assurance and continuous improvement program. In addition, in its June 2017 report, the Receiver's Office reported modifications to its statewide performance improvement plan to update and account for new or changing high-priority initiatives, court mandates, and community health care standards. These updates to its plan demonstrate the continuous nature of its program. Lastly, the

director of the office of communications and legislation also indicated that the establishment of the Electronic Health Records System (Health Records System) will allow the Receiver’s Office to meet the one remaining action for establishing medical support and allied health infrastructure. According to the tri-annual report, the Health Records System will provide Corrections demonstrable and sustained benefits to patient safety, quality and efficiency of care, and staff efficiencies and satisfaction. The Receiver’s Office reported that it completed implementation of the Health Records System statewide in October 2017.

The one action remaining to meet the goal of providing for necessary clinical, administrative, and housing facilities requires Corrections to complete upgrades to administrative and clinical facilities. In its June 2017 tri-annual report, the Receiver’s Office noted that clinical facility upgrades were progressing. Corrections staff stated that it has undertaken multiple construction projects to upgrade the facilities and some have already been completed. They estimated the construction projects will all be completed by March 2020. However, until these upgrade projects are complete, Corrections’ health care program will remain under federal receivership.

In March 2015, the federal court issued an order that reinforces a process for incremental delegation of authority back to Corrections over headquarters’ functions and over the institutions. The March 2015 Order maintains the existing process through which the Receiver’s Office delegates authority to Corrections, but more significantly, it requires the Receiver’s Office to consider information obtained from monitoring activities when making a delegation decision. Further, the March 2015 Order states generally that after the Receiver’s Office delegates all authority back to Corrections for one year without revocation, the prison medical care system is presumed to be constitutionally adequate and sustainable, unless proven otherwise. Although the federal court has made clear that the authority the Receiver’s Office delegates to Corrections can be revoked, the March 2015 Order offers a clear path toward the eventual termination of the receivership. The text box offers additional detail from the March 2015 Order.

### Summary of the Federal Court’s Receivership Transition Plan Dated March 2015

In March 2015, the federal court issued the March 2015 Order that modifies the plan to transition inmate medical care from the California Correctional Health Care Services, under the direction of the federal court-appointed receiver—which we collectively refer to as the *Receiver’s Office*—back to Corrections. The March 2015 Order establishes the process for incremental delegation of authority over systemwide and headquarters functions, and individual institutions from the Receiver’s Office back to Corrections as generally summarized below.

#### Certain requirements related to delegating or revoking authority:

- The Receiver’s Office must meet and confer with the parties and consult with the court experts before granting a delegation of authority.
- The plaintiffs may monitor care at the institutions for one year after authority has been delegated to Corrections. Plaintiffs’ monitoring ends after one year unless the Receiver’s Office revokes the delegation or the plaintiffs bring a successful motion before the federal court.
- The Receiver’s Office must regularly, but not less than monthly, evaluate whether it should revoke any delegations. However, before revoking a delegation, it must meet and confer with the parties and consult with the court experts.
- Any party who disagrees with the Receiver’s Office’s decision to delegate authority, or to revoke authority, may challenge that decision before the federal court.

#### Certain requirements after delegation:

- The Receiver’s Office will retain its powers over the inmate medical care system until the underlying court case terminates.
- The Receiver’s Office must certify for the court that it has transferred all headquarters’ functions and institutions to Corrections once it has done so. Within 30 days of the Receiver’s Office’s certification, Corrections must file a governance plan with the court. Plaintiffs have 30 days to challenge Corrections’ plan.
- If the Receiver’s Office leaves all delegations in place without revocation for one year following certification to the federal court, then a rebuttable presumption of constitutional adequacy and sustainability will be created. The plaintiffs have 120 days to challenge the presumption. If no challenge is made, the parties must promptly file a stipulation and proposed order with the federal court terminating the federal receivership and underlying court case.

Source: United States District Court Order dated March 10, 2015.

In its March 2015 Order, the federal court directed the Receiver's Office to continuously evaluate whether more revocable authority can be delegated back to Corrections. In our April 2015 report, we noted that as of February 2015, the Receiver's Office had delegated to Corrections authority over three operational areas: construction, medical facility activation, and health care access. As of June 2017, the Receiver's Office reported that it continues to monitor these operational delegations, and that none of them has been revoked. No new delegations of authority over operations have been made since our last review.

#### Prisons delegated back to Corrections:

- Avenal State Prison
- California City Correctional Facility
- California Correctional Institution
- California Institution for Men
- California Institution for Women
- California State Prison, Centinela
- Calipatria State Prison
- Correctional Training Facility
- Chuckawalla Valley State Prison
- Folsom State Prison
- Kern Valley State Prison
- Pelican Bay State Prison
- Pleasant Valley State Prison
- San Quentin State Prison
- Sierra Conservation Center

#### Prisons for which meetings are scheduled to discuss delegation back to Corrections:

- California Health Care Facility, Stockton
- California Men's Colony
- California Substance Abuse Treatment Facility and State Prison, Corcoran
- Deuel Vocational Institution
- High Desert State Prison
- Richard J. Donovan Correctional Facility

Source: Director, Office of Communications and Legislation, Receiver's Office.

When we asked the Receiver's Office about its plans for returning full authority over the prisons to Corrections, the director of the office of communications and legislation stated that the Receiver's Office has delegated several prisons back to Corrections. Additionally, the Receiver's Office and Corrections have scheduled meetings to discuss delegation of additional institutions. These are listed in the text box.

Although the federal court has established a process for transitioning the prison medical care system from the Receiver's Office back to Corrections, this transition process will take time. Until Corrections demonstrates that it can adequately manage functions related to inmate medical care and until the Receiver's Office delegates complete authority back to Corrections, the issue continues to present a substantial risk of serious detriment to the State and is one factor contributing to Corrections continuing to be at high risk.

#### ***Corrections' Lack of a Fully-Implemented Succession Management Program Creates Uncertainty About Its Ability to Maintain Consistent Leadership and Contributes to It Remaining a High-Risk Agency***

In our past high risk reports, we expressed concern over the significant number of vacancies in Corrections' leadership positions, its lack of a leadership succession plan, and its lack of a timeline for completing such a plan. Although Corrections has made progress in filling vacant leadership positions, it still has not fully implemented a succession management program, and it may struggle to ensure the availability and quality of the future leaders it will need. Thus, despite the progress it has made, it has not eliminated the substantial risk of serious detriment to its operations. As a result, uncertainty about Corrections' ability to maintain consistent leadership remains a factor contributing to its status as a high-risk agency.

In our April 2015 report, we noted that although Corrections had experienced some vacancies, it had made significant improvement from the recent past, when it had up to 38 percent of its positions vacant or filled by staff in an acting capacity. Additionally, we reported that as of February 2015, 12 of the 35 wardens overseeing the institutions' day-to-day operations were acting wardens. We also noted that although this number might seem high, the Office of the Inspector General's (Inspector General) 2014 annual report stated that warden candidates typically serve as acting wardens for at least three months before the State begins its vetting process. The Inspector General leads the vetting process, which includes subjecting the candidates to background investigations, site visits, interviews, and stakeholder surveys; at its conclusion, the Inspector General makes a confidential recommendation to the Governor. During our current review, we found that Corrections continues to make progress in reducing the number of vacant leadership positions. According to its May 2017 organizational chart, only one senior leadership position is vacant and none are filled by acting employees, an improvement from its 2015 and 2016 organizational charts; and as of June 2017, only six of the 35 warden positions are filled by acting employees. Additionally, Corrections indicated that it continues to follow the established warden-vetting process led by the Inspector General.

Corrections has developed a plan for a succession management program. Our April 2015 report expressed our concern that Corrections still lacked both a succession plan and a timeline for completing one. In that report, we also noted that although Corrections had previously anticipated reestablishing succession planning and training units, it had not done so and lacked authorized positions dedicated to developing a succession plan. In November 2017, Corrections completed a formal written succession plan. The plan provides an overview of the Succession Management Program, which a manager in Corrections' Succession Management Unit described as a set of structured activities and elements with more detail and sustainability than a traditional succession plan. Further, the manager stated that Corrections' program is a traditional succession management concept and Corrections is developing program components that include monitoring and evaluation for continual readiness of a talent pool. Specifically, in January 2017, Corrections approved a project charter and statement of work for its Succession Management Program, which includes five phases as shown in the text box.

**Corrections' Plan to Develop and Implement a Succession Management Program**

- Phase 1: Develop project plans.
- Phase 2: Develop a model.
- Phase 3: Develop implementation, training, communication, and sustainability plans; create a performance dashboard.
- Phase 4: Implementation, which includes designing and conducting a pilot study, evaluating pilot, statewide implementation and delivery of the program.
- Phase 5: Evaluation.

Source: Corrections' Succession Management Program plan.

Corrections' management program is expected to be fully implemented by December 2018. However, the project director stated that the Succession Management Program is continuous and evolving. It is intended to establish a pipeline of current employees who will be competitively skilled for executive leadership appointments. The program's objectives include creating tools, resources, and training to help identify potential leaders and to develop employees' individual career plans. The objectives also include developing a sustainable plan to forecast future employment needs; developing a methodology for identifying positions that are critical to its business needs; preparing employees to fill vacant leadership positions; ensuring that leadership training aligns with the needs for the development of future leaders; enhancing Corrections' ability to attract, develop, and retain employees with the competencies needed today; and addressing competencies required for future business needs. In addition, the objectives address creating and sustaining a succession program throughout the various functions within Corrections, a succession program that addresses each function's operational workforce needs. Although Corrections has begun developing and implementing its Succession Management Program, some time is needed before it is fully implemented. According to the Succession Management Program charter, phase 1 includes developing a plan for the Succession Management Program. In May 2017, Corrections prepared an update document that indicated it had completed much of phase 1 and it expected to complete that phase by June 2017. As of November 2017, Corrections indicated that it had one final step to finish phase 1 and it expected to complete it by the end of November 2017. Corrections also stated that it had begun working on phases 2, 3, and 4 and expects to complete them by December 2018. Corrections anticipates completing phase 5 in December 2019. However, without this program in place to help ensure the availability and quality of future leaders, Corrections may struggle to fill vacant positions and retain the leaders it will need. Consequently, we continue to consider this an area of high risk.

*Without a program in place to help ensure the availability and quality of future leaders, Corrections may struggle to fill vacant positions and retain the leaders it will need.*

### **Because of Unimplemented Recommendations Concerning Its Administration of the Mental Health Services Act, Health Care Services Remains a High-Risk Agency**

In our September 2013 report, we designated Health Care Services as a high-risk agency because of its new responsibilities under the Mental Health Services Act (MHSA). Subsequently, in a March 2015 letter report, we concluded that we would continue to designate Health Care Services as high-risk, in part because it had not fully implemented nine of the 12 recommendations from our August 2013 report. As of the last annual update that Health Care Services provided us on the status of these recommendations,



which we reported on in January 2017, we concluded that it is still working to implement seven recommendations. Five of these seven recommendations could pose a substantial risk of reduced health and safety of the vulnerable population that relies on publicly funded mental health programs. These recommendations include conducting comprehensive on-site reviews of county MHSA-funded programs, issuing necessary guidance or regulations to ensure that counties effectively implement and evaluate their MHSA programs, and collecting complete and relevant MHSA data from counties for evaluation.

In May 2017, Health Care Services indicated that it expects to fully implement the remaining recommendations before the end of 2018. It outlined steps it has taken or plans to take to implement these outstanding recommendations, and it provided updated timelines for full implementation. For example, we recommended that Health Care Services conduct comprehensive on-site reviews of county MHSA-funded programs including verifying county compliance with MHSA requirements. Health Care Services asserted that it has not yet fully implemented this recommendation, but it has included MHSA-related questions in its triennial Medi-Cal reviews and it conducts fiscal audits of local MHSA funds. Further, Health Care Services indicated that it is recruiting staff to perform on-site program reviews of county performance contracts and that once staff are hired and the review process and protocol are finalized, it will begin performing the on-site program reviews as we recommended. Until Health Care Services has fully implemented our recommendations regarding its increased responsibilities under the MHSA, we have little assurance that it has resolved this area of risk.

### **Health Care Services Has Not Addressed Recommendations Related to Concerns With Its Beneficiary Eligibility System**

In our September 2013 report, we designated Health Care Services as high-risk, in part because of the number of new beneficiaries eligible for Medi-Cal. We subsequently concluded in a 2015 letter report that Health Care Services continued to be high-risk because of outdated information in its eligibility system that resulted in payments for services purportedly provided to deceased beneficiaries, among other issues. Specifically, in audit reports related to the Medi-Cal dental and drug programs, as well as in a management letter regarding the In-Home Supportive Services Program audit, we determined that the State paid more than \$1.2 million for services related to Medi-Cal-eligible beneficiaries that had been identified by the U.S. Social Security Administration as deceased. We also concluded that the failure to identify deceased beneficiaries could have even greater implications related to other programs that rely on the eligibility system's data.

Although we previously recommended that Health Care Services follow up regarding deceased beneficiaries and recover any inappropriate payments, it has not fully implemented these recommendations. For example, Health Care Services has not demonstrated that it analyzed whether the beneficiaries we identified in our audit of the Medi-Cal dental program were actually deceased, and if they were not deceased, whether the beneficiaries were eligible for benefits under their corrected Social Security numbers. Even though it has not done further investigating, Health Care Services believes these applicants used fraudulent or erroneous Social Security numbers to gain Medi-Cal benefits. Health Care Services explained that when applicants apply for benefits, it attempts to verify their Social Security numbers. If the Social Security number cannot be verified, Health Care Services forwards the information to the county eligibility office to follow up. However, applicants who are otherwise eligible for benefits continue to receive services while the county eligibility offices follow up on the failed verification.

To verify the applicants' eligibility for federal aid, federal regulations require states to ensure that applicants furnish their Social Security numbers, with specified exceptions. Aid is provided to the applicants during the social security verification process; however, federal regulations require that aid be terminated if certain information cannot be verified within 90 days, unless the deadline is extended under specified circumstances. When we analyzed eight million beneficiaries that Health Care Services identified as eligible to receive federal aid for the full scope of Medi-Cal services in June 2017, we found that 119,000 of the beneficiaries were still in the verification process.<sup>4</sup> However, the majority of these beneficiaries had been eligible for significantly more than 90 days. In fact, nearly 83,000 of the beneficiaries had been eligible for more than 12 months—and 16,000 had been eligible for the entire period of our analysis, which spanned nearly four years.

We also identified other beneficiaries that Health Care Services deemed eligible for federal aid who may not be eligible. Specifically, beneficiaries with certain immigration statuses, such as students and tourists, are typically not eligible to receive federal aid for the full scope of Medi-Cal services. We identified over 10,000 beneficiaries with statuses that likely disqualify them from receiving such aid, yet Health Care Services listed these beneficiaries as eligible in June 2017. We asked Health Care Services to research five of these beneficiaries and the chief of the Medi-Cal Eligibility Division Process Unit confirmed that the eligibility of all five of the beneficiaries for this aid

***We found nearly 83,000 Medi-Cal beneficiaries whose eligibility remained in question for more than 12 months.***

<sup>4</sup> We considered beneficiaries still in the verification process if they had an unverified social security number, were referred to the U.S. Social Security Administration to obtain a social security number, or had applied for a social security number.

was in error. Further, we found 468 beneficiaries with verified Social Security numbers that were identified by the U.S. Social Security Administration as being deceased before 2017.

We discussed these issues with Health Care Services' staff, but they did not share their perspective. Regardless, Health Care Services does not have assurance that payments associated with a beneficiary are appropriate when the beneficiary's Social Security number is not verified, when a beneficiary's immigration status does not qualify him or her for federal aid, or when the U.S. Social Security Administration identifies the beneficiary as deceased. Because the State could be liable to the federal government for overpayments of federally funded aid, Health Care Services remains a high-risk agency.

***California could be liable for overpayments of federally funded aid.***

### **Public Health Remains a High-Risk Agency Because of Unimplemented Recommendations That Could Affect Public Health and Safety**

In our September 2013 report and subsequently in our March 2015 update letter report, we determined that Public Health remained a high-risk agency because of weaknesses in its program administration and because it had been slow to implement numerous recommendations that had been outstanding for longer than a year. In fact, we reported that Public Health's unresolved recommendations that were more than one year old had increased since our September 2013 report from 22 to 33—more than half of which had a direct impact on public health and safety. In January 2017, we reported that Public Health had 22 unresolved recommendations from previous audits more than one year old. Additionally, several of the estimated completion dates Public Health had set for implementing the unresolved recommendations would not occur until late 2017 and beyond. Our current review revealed that although Public Health has made considerable progress towards implementation of four of the 22 outstanding recommendations, these incomplete changes could still pose substantial risk of the loss of life, significant injury, or a broad reduction in residents' overall health or safety if the recommendations remain unimplemented.

Specifically, in our October 2014 report, *California Department of Public Health: It Has Not Effectively Managed Investigations of Complaints Related to Long-Term Health Care Facilities*, Report 2014-111, we found that Public Health did not consistently initiate investigations or close complaints about long-term health care facilities within the required time frames established in law. For example, as of April 2014, Public Health had more than 10,000 open complaints and investigations of incidents that facilities had self-reported—generally referred to as *entity-reported incidents*—related to long-term health care facilities and nearly

1,000 open complaints against individuals, including certified nurse assistants and home health aides, who provide care at those facilities. We reported that many of these open complaints and entity-reported incidents had relatively high priorities—indicating a safety risk to the residents—and had remained open for nearly a year on average. As a result, we made several recommendations for improving Public Health’s oversight of complaint processing, including four recommendations that, if not implemented, would place the well-being of residents of long-term health care facilities at risk. In particular, we recommended that Public Health establish a specific time frame for completing facility-related complaint investigations and entity-reported incident investigations, and that it develop formal written policies and procedures that include specific time frames for prioritizing and assigning complaints to investigators, initiating investigations, and completing investigations. Further, we recommended that Public Health ensure that its district offices have adequate staffing for its licensing and certification responsibilities, including staffing levels that allow prompt investigations of complaints, and that it ensure that its district offices follow procedures requiring supervisory review and approval of investigations of complaints and entity-reported incidents.

Although Public Health has created procedures to guide the investigation process for complaints about certified individuals and the Legislature amended state law to include time frames for investigations of complaints against facilities, Public Health does not intend to establish time frames for investigations of entity-reported incidents or complaints against certified individuals. Public Health’s acting deputy director of its Center for Health Care Quality (acting deputy director) stated that by establishing time frames in law for investigations of complaints against facilities, the Legislature made it clear that these investigations are a higher priority than those of entity-reported incidents or complaints against certified individuals. Nevertheless, we believe it is good practice for Public Health to set time frames for completing all types of investigations of certified professionals to ensure that they are completed in a timely manner and to ensure public health and safety. Further, according to the acting deputy director, Public Health has yet to finish reclassifying certain positions and completing its hiring of additional personnel to ensure that it has adequate staffing to fulfill its licensing and certification responsibilities. Without sufficient staffing and by not including time frames for investigations of entity-reported incidents or complaints against certified individuals in its policies and procedures, Public Health is placing the health and safety of residents of long-term health care facilities at risk. When Public Health’s actions result in significant progress, based on our professional judgment, toward resolving or mitigating these risks, we will remove the high risk designation.

***Without sufficient staffing and by not including time frames for investigations of entity-reported incidents or complaints against certified individuals in its policies and procedures, Public Health is placing the health and safety of residents of long-term health care facilities at risk.***

## **Agency Comments**

### ***Covered California***

Covered California stated that it recognizes that federal health care policies are currently under review and agrees there is a great deal of uncertainty at the federal level. It explained that it prepares for this uncertainty by monitoring proposed changes and remaining ready to respond to those changes. Covered California added that it intends to fully implement the remaining recommendation from our February 2016 report once its leadership finalizes the listing of specific contracts that it could reduce or cut in the event of a revenue shortfall. Covered California stated that it continues to maintain strong enrollment and sound financial footing as evidenced by more than 102,000 new consumers signing up for coverage during November 2017, representing a 28 percent increase in enrollment over the same period the previous year.

### ***Corrections***

Corrections provided updates related to some of the information in our assessment. Although we have revised the text to reflect the updated information, the updates did not affect our assessment of high risk.

### ***Health Care Services***

Health Care Services stated that it continues to work towards full implementation of the recommendations from our August 2013 report and expects to achieve full implementation during 2018. Health Care Services acknowledged that it continues to strive to improve the public mental health system and believes the implementation of our recommendations will contribute to these efforts. Health Care Services asserted that it analyzed the potentially deceased beneficiaries we identified in a previous report. However, despite repeated requests for support for these assertions, Health Care Services has not provided us with any evidence of its work. Health Care Services also pointed out that some beneficiaries' nonemergency services are funded solely by the State. This comment distracts from our point, because as we have repeatedly explained to Health Care Services, our analysis only includes beneficiaries receiving federal aid for the full scope of Medi-Cal services.

### ***Public Health***

Public Health did not provide written comments to our draft report.

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# CHAPTER 3

## Effective Oversight of Information Technology

HIGH-RISK ISSUE	RESPONSIBLE AGENCY
<b>INFORMATION TECHNOLOGY OVERSIGHT</b>	
Although the Technology Department has adopted a new project approval process, the actual benefits of the new process may not be fully realized for several years.	Technology Department
Some IT projects continue to face significant cost increases and schedule delays, and some departments continue to use inefficient IT systems.	
<b>INFORMATION SECURITY</b>	
Although the Technology Department is working to clarify the information in the security standards—Chapter 5300 of the <i>State Administrative Manual</i> —and is developing a new self-assessment tool to assist reporting entities in achieving compliance with the security standards, it has yet to fully implement all of our recommendations.	Technology Department
More than 90 percent of the participants in our information security survey reported that they have yet to achieve full compliance with state information security standards.	

### IT Oversight Remains a High-Risk Issue Because State Agencies Continue to Struggle to Implement New Information Systems and Because the Technology Department’s New Process for Helping Them Has Only Recently Been Implemented

In our September 2013 report, we determined that the State’s oversight of IT projects was a high-risk issue because of the high costs of certain projects and the failure of others. Additionally, in our March 2015 update report, *High Risk Update—California Department of Technology: Lack of Guidance, Potentially Conflicting Roles, and Staffing Issues Continue to Make Oversight of State Information Technology Projects High Risk*, Report 2014-602 (March 2015 report), we highlighted challenges resulting from the inability of the Technology Department to effectively provide IT project oversight. For example, we found that the Technology Department’s independent project oversight analysts lacked clear guidance for when to escalate problems to their managers and the Technology Department also lacked criteria for the conditions that would lead it to consider suspending or terminating projects.

As of October 2017, the Technology Department reported that 26 medium and high criticality IT projects, with an aggregate cost of more than \$3 billion, were under development. For some of these projects, the Technology Department cautioned that risks exist and that there may be a need for corrective actions. As a result, some of the projects have experienced significant delays and cost

***The contract for the Child Welfare Services New System Project has undergone two amendments that have increased the cost to \$421 million and delayed the implementation date to December 2019.***

increases. For instance, since the Financial Information System for California (FI\$Cal)—an IT project aimed at replacing the State’s aging and decentralized IT financial reporting systems—began in 2005, it has changed many times in scope, schedule, and cost. The sixth amendment to FI\$Cal’s contract extended the system’s implementation by two years and increased its estimated cost by \$237 million to a total cost at that time of \$910 million. Further, FI\$Cal’s June 2017 executive project status report identified further delays caused by defects and design changes.

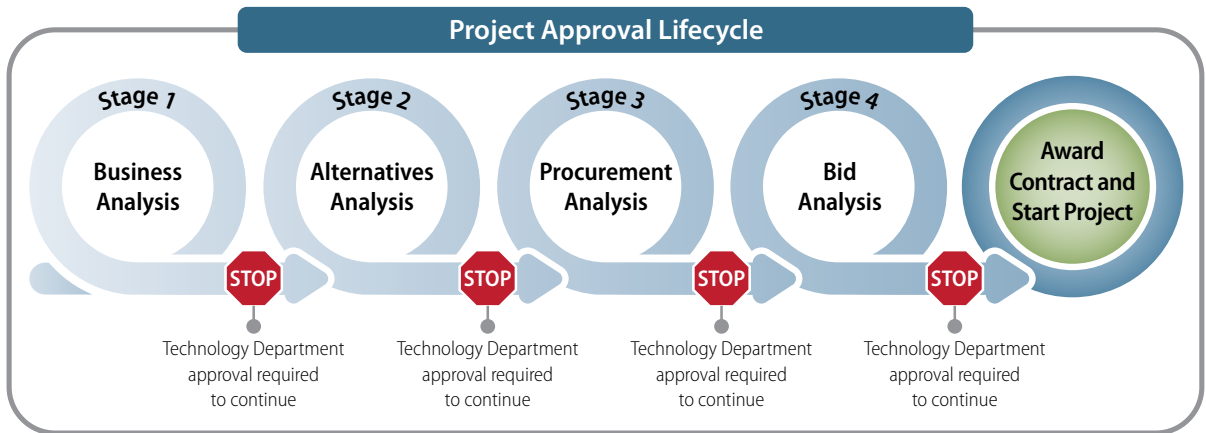
Similarly, the State Treasurer’s Office (Treasurer’s Office) has amended the project for its nearly \$20 million Debt Management System twice, increasing the project’s cost, modifying its timeline, and revising its approach to include multiple vendors working concurrently. Most recently, the Treasurer’s Office’s June 2017 executive project status report showed that the project would likely be late in meeting eight out of 11 milestones during that month. Furthermore, when the California Department of Social Services (Social Services) began its Child Welfare Services New System Project in July 2013, it estimated that it would cost roughly \$393 million and it would be implemented by September 2017. However, the contract for the project has since undergone two amendments that have increased the cost to \$421 million and delayed the implementation date to December 2019.

Subsequent to the initiation of the systems cited above, the Technology Department implemented in 2016 a new IT project approval process, called the Project Approval Lifecycle (PAL), which the department believes will bolster project planning and reduce the likelihood of project challenges and failures. As Figure 5 shows, PAL divides the Technology Department’s approval process into four stages and requires sponsoring agencies to conduct specific planning-related analyses and to submit associated planning documents to the Technology Department. Sponsoring agencies must also secure the Technology Department’s approval for each of the four stages before they can begin the IT projects.

Although PAL may improve IT project implementation, the State may not realize the benefits of the new approval process for several years. Moreover, the Legislative Analyst identified some trade-offs with PAL. For example, because PAL requires more robust planning and detailed analysis upfront, the process will likely take longer for agencies to complete and will require more resources. The Legislative Analyst also cautioned that because PAL is relatively new, the length of the process is uncertain. The Technology Department reported that 47 project proposals are currently undergoing planning through PAL; it has approved five projects through stage four and they took an average of 16 months. Because no projects have been fully implemented after undergoing PAL, we will have to wait to assess the impact PAL has on projects’ implementation time frames.



**Figure 5**  
 The Technology Department Designed Specific Opportunities to Reject Inadequate Project Proposals in the Project Approval Lifecycle Process



Source: California State Auditor’s analysis of information from the Legislative Analyst’s report titled *The 2017–18 Budget: The New IT Project Approval and Funding Process* (February 2017).

Because the State faces challenges in implementing IT projects, some agencies are continuing to use inefficient IT systems. These IT systems—commonly referred to as *legacy systems*—are often decades old, present compatibility issues, or lack functionality. Their inefficiency and potential for failure impact both the internal administration of state government and the external services the State provides; thus, the systems pose a significant risk to the State. For example, the Secretary of State’s Office (Secretary of State) is working on the California Business Connect Project, which will consolidate into one automated system the patchwork of 23 IT systems that its Business Programs Division (business division) is now using. The current IT systems lack uniformity in functionality, data entry, and data capture, creating data integrity issues. To mitigate these issues, the business division must physically receive business filings that it then manually enters into the appropriate systems. It then must file these physical documents so it can retrieve them if information is requested. According to the Secretary of State, this labor-intensive process puts manually entered data at risk from human error, as the systems lack the ability to validate processed information. That time-consuming process also leads to backlogs that affect both businesses that need the Secretary of State’s approval to initiate important business functions and government agencies that rely on the Secretary of State for information. The Secretary of State formally began the California Business Connect Project in 2011 with the expectation that the project would be completed by June 2017. However, according to the Secretary of State’s latest special project report, that date has been pushed back to January 2022.

The State Controller's Office (State Controller) also has a legacy system that has disrupted its ability to perform its most important functions. The State Controller is responsible for paying the salaries and wages of the State's workforce, including state civil service, California State University (CSU), and Judicial Council employees. However, its current system is costly and difficult to maintain, and few current IT personnel have knowledge of the programming language that was used to develop it in the 1970s. The State Controller proposed developing a replacement system in 2004. However, after many delays, including terminated vendor contracts in 2009 and 2013, it officially closed that project in November 2016. One month later, the State Controller started a new planning process, and as of May 2017, the Technology Department was reviewing its PAL phase one business analysis. Until the State Controller completes all four phases of PAL, we cannot examine the likelihood of the project remaining within budget and on time.

The Secretary of State and State Controller are just two examples of the degree to which legacy systems have affected state agencies' ability to perform their most important functions. These examples emphasize the need for the State to undertake IT projects to replace these outdated systems and improve the efficiency of state programs. Although PAL is expected to mitigate some project challenges and improve project success, it is still in its infancy and is still being modified. According to the acting chief project officer of the Office of Statewide Project Delivery at the Technology Department, staff have already identified opportunities to improve PAL and plan to develop and implement changes during fiscal year 2017–18. Given that the State has experienced considerable challenges in successfully implementing IT projects, we will continue to monitor the Technology Department's oversight of IT projects.

*Given that the State has experienced considerable challenges in successfully implementing IT projects, we will continue to monitor the Technology Department's oversight of IT projects.*

### **Although the Technology Department Has Made Progress Improving Its Oversight, Information Security Remains a High-Risk Issue**

In our September 2013 report and in our August 2015 follow-up report, *High Risk Update—Information Security: Many State Entities' Information Assets Are Potentially Vulnerable to Attack or Disruption*, Report 2015-611 (August 2015 report) we noted deficiencies in the information system controls, intended to safeguard information, that certain state agencies implemented for their information systems. We also noted that the Technology Department performed limited reviews to assess those controls. The pervasiveness of the control deficiencies, combined with the Technology Department's limited oversight led us to designate the Technology Department's oversight of information system controls a high-risk issue. Although the Technology Department has made some progress in its oversight, information security remains a high-risk issue to the State because of continued deficiencies in information system controls.

The State's information assets are an essential public resource. In fact, many state entities' program operations would effectively cease in the absence of key information systems. In some cases, the failure or disruption of information systems would jeopardize public health and safety; and the unauthorized modification, deletion, or disclosure of information included in the State's files and databases could compromise the integrity of state programs and violate individuals' right to privacy. Not only can information system breaches of government entities impede the agencies' ability to meet their missions, but they can also prove costly. A 2017 Ponemon Institute study estimated that the average cost per record lost in the public sector is \$110, placing government entities at risk of incurring significant expenses should they fall victim to a breach of sensitive information.

The Technology Department serves as the primary state government authority responsible for ensuring the confidentiality, integrity, and availability of state systems and applications for certain executive branch entities. The Technology Department's Office of Information Security (security office) is responsible for providing statewide strategic direction and leadership in the protection of the State's information assets. To this end, state law provides the security office with the responsibility and authority to create, issue, and maintain policies, standards, and procedures, some of which the security office has documented in the security standards. The security standards provide the security and privacy policy framework with which state entities under the direct authority of the Governor (reporting entities) must comply. The Technology Department measures compliance with the security standards through self-certifications, security assessments, and audits of reporting entities.

In our August 2015 report, we made nine recommendations to the Technology Department to assist reporting entities in reaching full compliance with the security standards, to improve the clarity of those standards, and to provide more effective oversight. We also issued recommendations to five reporting entities, whose compliance with the security standards we reviewed. Since that report was issued, the Technology Department and the five reporting entities have made progress toward implementing these recommendations. As shown in Table 2 on the following page, the Technology Department has fully implemented four of the recommendations and has made progress toward fully implementing the remaining five. Additionally, one of the five reporting entities fully implemented our recommendations, and the remaining four reported that they have also made progress toward achieving full implementation.

***A recent study estimated that the average cost per record lost in the public sector is \$110, placing government entities at risk of incurring significant expenses should they fall victim to a breach of sensitive information.***

**Table 2**  
The Technology Department Has Made Some Progress in Implementing Recommendations as of November 2017

STATE AUDITOR'S RECOMMENDATIONS	STATUS AS OF NOVEMBER 2017	
	FULLY IMPLEMENTED	IN PROGRESS
<b>Assisting Reporting Entities in Reaching Full Compliance With Security Standards</b>		
Develop a self-assessment tool by December 2015 that reporting entities can use to determine their level of compliance with the security standards. The Technology Department should require reporting entities to submit completed self-assessments along with their self-certifications.		✓
Provide more extensive guidance and training to reporting entities regarding the self-certification process, including training on how they should use the new self-assessment tool.		✓
Develop internal policies and procedures to ensure that it reviews all reporting entities' self-assessments and self-certifications, including requiring supporting evidence of compliance when feasible.	✓	
Annually follow up on the remediation plans that reporting entities submit.	✓	
<b>Providing Effective Oversight</b>		
Expand on its pilot audit program by developing an ongoing risk-based audit program. If the Technology Department requests additional resources, it should fully support its request.	✓	
Revise its certification form to require reporting entities to submit detailed information about their compliance with the security standards. It should use this information to track and identify trends in the State's overall information security.		✓
Develop policies and procedures to define the process and criteria it will use to incentivize entities' compliance with the security standards.		✓
<b>Improving the Clarity of Security Standards</b>		
Perform regular outreach to all reporting entities to gain their perspectives, identify any unclear or inconsistent security standards, and revise them as appropriate.		✓
Develop and regularly provide detailed training on the requirements of the security standards and on best practices for achieving compliance. It should provide these trainings in a variety of locations and formats, including webinars.	✓	

Sources: California State Auditor's recommendations in our August 2015 report and our analysis of the Technology Department's corrective actions.

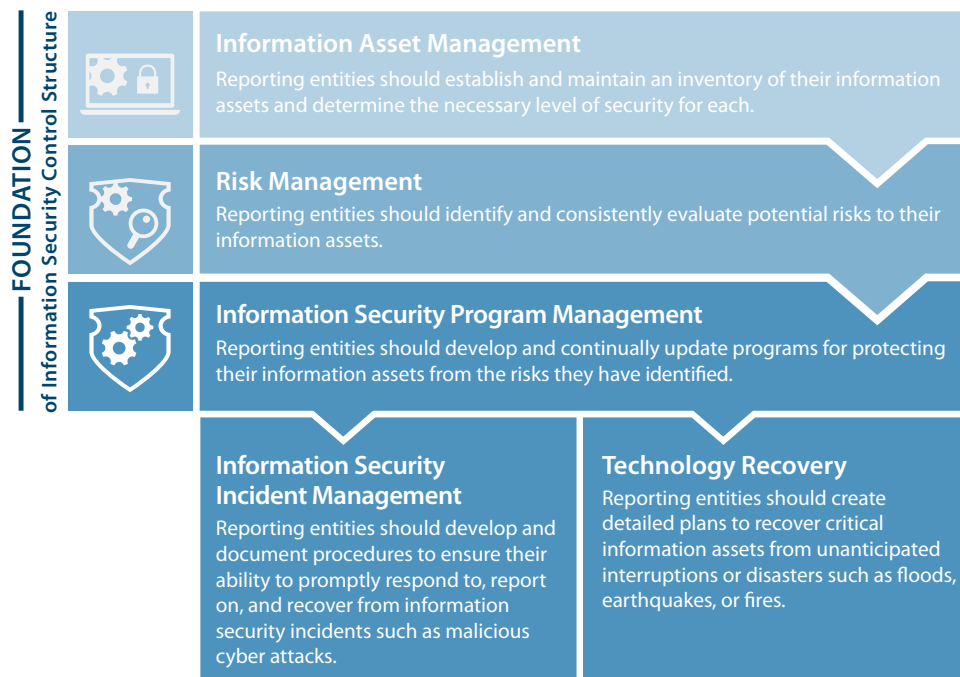
The Technology Department is developing a new tool in response to several of the recommendations: the California Compliance and Security Incident Reporting System (Cal-CSIRS). This system will eventually allow reporting entities to identify and correct their information security control deficiencies, and it will help the security office to monitor and mitigate related statewide problems or trends. As of May 2016, the system was in use for reporting information security incidents statewide, and by May 2018, the Technology Department plans for all information security compliance-related reporting to be completed using Cal-CSIRS. The Technology Department is also developing training on how to use the new system.

To gain stakeholder input on improving the security standards, the Technology Department conducted workshops with information security personnel throughout the State; these workshops were also presented online. In response to the feedback it received, the

Technology Department states it has identified areas for improvement to the security standards, and it plans to have completely reviewed and revised the security standards with community feedback by July 2018.

While the Technology Department has made strides toward assisting reporting entities in achieving compliance and improving the clarity of the security standards, there is still significant room for improvement. As part of our August 2015 audit, we surveyed 101 entities and asked them to designate their compliance status with each of the 64 sections of the security standards. To assess the survey respondents' self-reported levels of compliance with the security standards, we categorized select security standards into five key control areas. As Figure 6 shows, three control areas form the foundation of an effective information security structure, and two control areas relate to a reporting entity's ability to respond to incidents and disasters. At the time of our August 2015 audit, 73 of the 77 entities that responded to the survey indicated they were not in full compliance with the security standards.

**Figure 6**  
**Reporting Entities Must Comply With Five Key Control Areas**

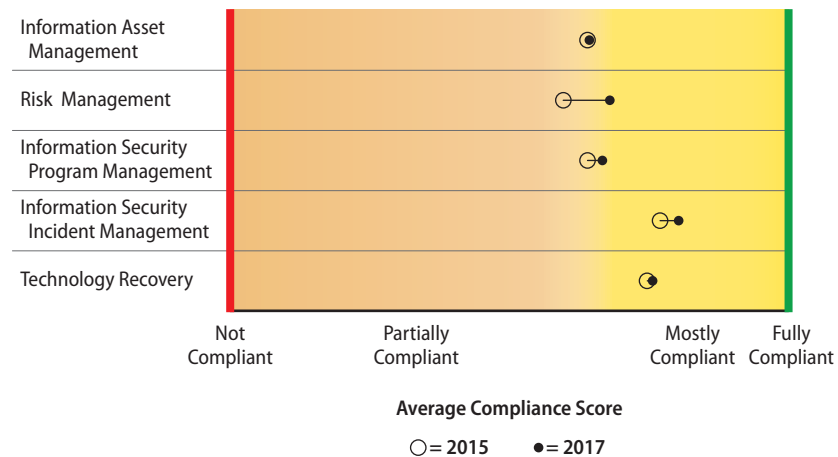


Source: California State Auditor's assessment of the security standards.

Note: We focused our review on the five key control areas above, which include 17 of the 64 sections of the security standards.

To assess whether a lack of compliance with the security standards remains a significant risk to the State, we surveyed the same 101 entities from our August 2015 audit and found that the results were similar, 81 of the 87 survey respondents self-reported that they are not fully compliant with the security standards. In fact, 62 percent of respondents do not anticipate that they will achieve full compliance with the security standards until 2019 or later. However, as shown in Figure 7, the average compliance scores on the information security survey increased since the 2015 survey, with the largest increase in the category of risk management—one of the control areas that form the foundation of an effective information security structure. However, despite this increase in self-reported compliance, Figure 7 shows that reporting entities still have significant room for improvement and the lack of compliance with the security standards remains a significant risk to the State. Table B beginning on page 74 in Appendix B presents the respondents’ compliance levels in more detail.

**Figure 7**  
**Average Compliance Scores on the Information Security Survey Increased From 2015 to 2017**



Source: California State Auditor’s analysis of state entities’ 2015 and 2017 survey responses.  
Note: The entities that responded to the survey in 2015 varied from the entities that responded in 2017.

- = **Fully compliant:** The entity asserted that it is fully compliant with all of the security standards for the control area.
- = **Mostly compliant:** The entity asserted that it has attained nearly full compliance with all of the security standards for the control area.
- = **Partially compliant:** The entity asserted that it has made measurable progress in complying, but has not addressed all of the security standards for the control area.
- = **Not compliant:** The entity asserted that it has not yet addressed the security standards for the control area.

The information security practices of state entities outside the purview of the Technology Department's oversight could also be an area of concern. As we noted in our August 2015 audit report, the Technology Department only has oversight authority for information security over state entities that report directly to the Governor, and many other state entities are not subject to its security standards or oversight. The information security practices of state entities outside the purview of the Technology Department may warrant further investigation in the future.

### **Agency Comments**

The Technology Department highlighted in its response the significant improvement that PAL represents and stated that it is committed to improving upon this process and partnering with state agencies to promote success in the delivery of their IT projects. The Technology Department added that it is committed to ensuring the confidentiality, integrity, and availability of state data by continuing to improve its oversight program, and listed a number of actions it is taking to do so.

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# CHAPTER 4

## Access to Affordable and High-Quality Public Education

HIGH-RISK ISSUE	RESPONSIBLE AGENCY
<b>KINDERGARTEN THROUGH GRADE 12 (K–12) EDUCATION</b>	
State oversight does not ensure that local educational agencies spend funds in accordance with the local control funding formula (LCFF).	<ul style="list-style-type: none"> <li>• California Department of Education (Education)</li> <li>• State Board of Education</li> </ul>
Gaps in the State’s educational performance data may hamper the State’s ability to evaluate school districts’ performance and their implementation of common core state standards (common core).	
<b>HIGHER EDUCATION</b>	
The CSU and UC systems have retained policies that limit enrollment of resident students.	<ul style="list-style-type: none"> <li>• California Community Colleges (CCC)</li> <li>• California State University (CSU)</li> <li>• University of California (UC)</li> </ul>
CSU’s four-year graduation rates remain low, especially in critical fields, adding to the students’ time and cost of obtaining a degree.	
With increased funding, CCC has improved its ability to provide courses and services to students and is no longer considered high-risk.	

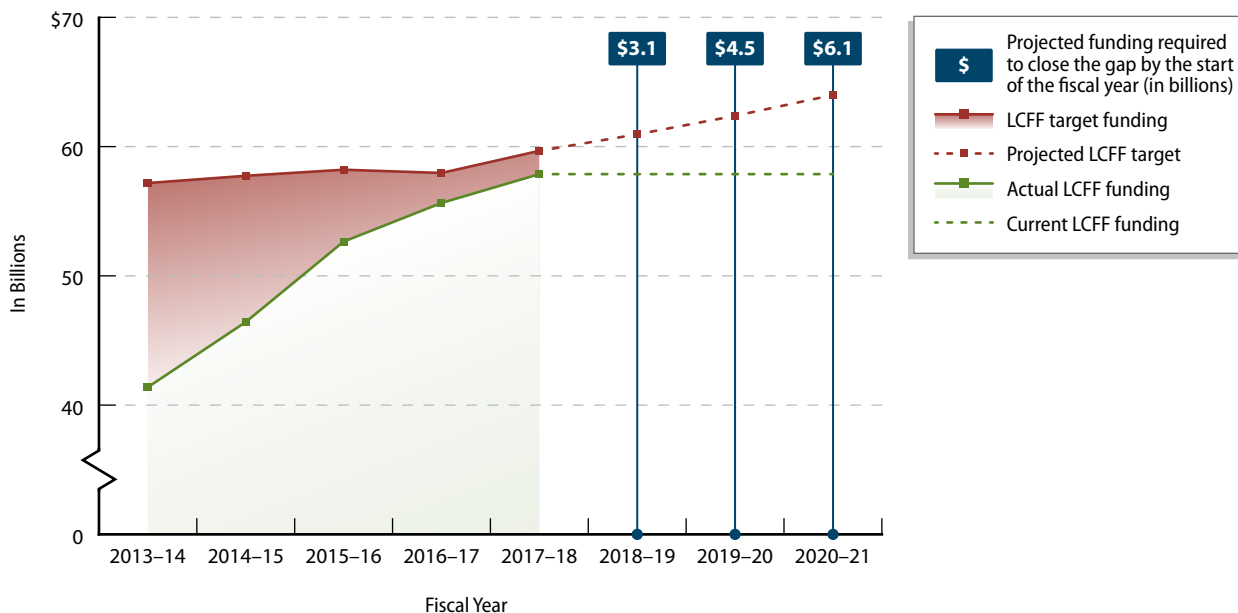
### K–12 Education Remains High-Risk Because of Gaps in Oversight From State Agencies

In December 2013, the State Auditor designated K–12 education as high-risk because of significant policy changes, including the State’s implementation of the LCFF and common core, which have created potential challenges associated with economy, efficiency, and effectiveness. Specifically, our December 2013 report cautioned that the LCFF implementation might lack adequate financial support and could create a gap in the State’s ability to assess the performance of school districts. The report also warned that the adoption of common core might place significant additional costs on school districts and endanger federal support for California’s schools. Our current review found that the State has significantly narrowed the LCFF funding gap and increased investment in common core implementation. However, because of a lack of State oversight, it is unclear whether school districts are using LCFF funds appropriately or effectively. In addition, the new testing methods implemented in large part for common core have reduced the State’s ability to track student achievement and thus its ability to hold districts responsible for student academic performance.

**State Oversight Does Not Ensure That Local Educational Agencies Spend Funds in Accordance With the LCFF**

In 2013 California embarked on an historic shift, which changed the way it funds K–12 education by giving local educational agencies more control over how those funds are spent. Under LCFF, the State gives local educational agencies a base grant amount for each student, along with supplemental and concentration funding to improve academic outcomes for low-income, English learner, and foster youth students, who are known as *unduplicated pupils*. The LCFF replaced the previous complex funding process and is intended to be simpler and provide more equity, transparency, and better performance. Since 2013 the State has demonstrated a commitment to reaching the funding targets that LCFF established. For instance, in fiscal year 2013–14, the State funded only 72 percent of the LCFF target level. In contrast, the fiscal year 2017–18 Budget Act provides local educational agencies 97 percent of the LCFF target or more than \$57.8 billion. However, as the target increases each year—to account for cost-of-living adjustments—increases in funding are required to close the gap, as shown in Figure 8. The Department of Finance estimates that the State will close the funding gap in fiscal year 2020–21, which will require the State to increase K–12 funding by \$6.1 billion over current levels of funding.

**Figure 8**  
**\$6 Billion Dollars Is Needed to Close the LCFF Gap Over the Next Three Years**



Source: California State Auditor’s analysis of information from Education’s website, including long-range funding snapshots and cost-of-living adjustment calculations.

Although the State is committed to closing the LCFF funding gap in the coming years, recent incidents indicate that funds designated for unduplicated pupils may not be reaching them. A recent lawsuit and concurrent Uniform Complaint Procedure filing alleged that the Los Angeles Unified School District (LAUSD) did not use its supplemental and concentration funding to increase or improve services for unduplicated pupils compared to the services provided to all pupils. In September 2017, the parties in the lawsuit reached a settlement through which \$171.6 million will be deducted and reallocated from existing LAUSD base programs or budget categories in fiscal years 2017–18, 2018–19, and 2019–20. Interest groups have lodged similar complaints against Long Beach Unified School District, and an April 2017 Policy Analysis for California Education report on LCFF implementation found that while districts appeared to make good-faith attempts to primarily direct concentration and supplemental grants to targeted groups, it was difficult to see how some investments met that requirement.

When it adopted the LCFF in 2013, the State created a process for monitoring the performance of local educational agencies through two key oversight elements. The first element is the local control and accountability plan (LCAP) that districts must complete and update annually. In addition to stating objectives and strategies, the LCAPs must list specific actions the districts intend to take to achieve those objectives. Further, state law requires the districts' LCAP to use certain metrics—such as college preparatory completion rates—to measure the students' achievements. State law also requires county offices to approve the districts' LCAPs. However, a 2017 audit by the State Auditor on the college readiness of California students found that districts reported incorrect data or superfluous data in their LCAPs, making it difficult to determine whether the districts had met their stated goals. Furthermore, a 2015 Legislative Analyst's report found that LCAPs varied widely in their level of detail, rarely differentiated between new and ongoing activities, included different funding sources, and did not always link funding to actions.

The second oversight element that state law requires is an evaluation tool that the State Board of Education approved in 2016, called the *dashboard*. It is intended to assist districts in evaluating their strengths, weaknesses, and areas that require improvement. The State made some data from the dashboard available to the public in March 2017; however, Education indicated that it would not use the data results in the dashboard to identify districts for technical assistance or intensive interventions until fall 2017. Furthermore, in a March 2017 press release, the State Board of Education president stated that the dashboard is a work in progress and predicted that it will be a far more valuable tool in one year and in three years as more indicators come online, as feedback is

***A 2017 audit by the State Auditor on the college readiness of California students found that districts reported incorrect data or superfluous data in their LCAPs, making it difficult to determine whether the districts had met their stated goals.***

incorporated, and as improvements are made. Therefore, the dashboard might assist oversight in the future, but more time must pass before we can assess its functionality and performance.

### ***Testing and Oversight Reforms Make It Difficult for the State to Hold School Districts Accountable for Academic Achievement***

In fiscal year 2013–14, the State committed \$1.25 billion to help local educational agencies offset the costs of implementing common core, a set of academic content standards in Math and English for K–12 students. Since then, the State has invested another \$3.5 billion for common core implementation. The State has also approved new curriculum frameworks and instructional materials, provided training resources for California educators, and begun standards-aligned testing. As of 2017, nearly all students in the State were taking online, common core-aligned assessments.

Nevertheless, gaps in the State’s educational performance data may hamper the State’s ability to evaluate district performance or evaluate the results of common core implementation. Specifically, when the State transitioned from the Standardized Testing and Reporting system in July 2013 to the California Assessment of Student Performance and Progress (CAASPP) system, it suspended statewide Math and English accountability testing for one year. The gap in student assessments compromised the ability of the State to track the academic performance of students during the interim period. In addition, the transition to CAASPP also erased the ability to compare districts’ performance to years past, as state law specifically bars the comparison of CAASPP assessments to previous types of assessments.

***As the State transitions to new science evaluations, which according to Education, will be operational in 2019, there will be a similar gap in assessments.***

As the State transitions to new science evaluations, which according to Education, will be operational in 2019, there will be a similar gap in assessments. Moreover, as the State performs pilot and field tests, it will encounter the same continuity issues. Specifically, in November 2013, California adopted the Next Generation Science Standards (new science standards), which, much like common core, are new nationally developed standards designed to improve science learning for K–12 students. As the State started implementing the new California Science Test, it ceased using older statewide science accountability testing and began piloting tests aligned with the new science standards in school year 2016–17 with all students in fifth and eighth grades and at least one grade in high school. In addition, the State proposed conducting a census field test with all students in those grades in school year 2017–18 and a full operational test in school year 2018–19. During the years in which it administers the pilot and field tests, the State proposed not administering its current science assessments and, consequently,

will not report individual student or school level data to parents, educators, or the public until 2019 for all students. Therefore, as with the implementation of common core, the transition will create a gap in science accountability results that may make it more difficult for the State to evaluate district performance.

Furthermore, the gaps in the assessment of school district accountability have limited the State's ability to fully assess or intervene in failing school districts. Specifically, when the State overhauled its standardized testing regime to implement common core, it suspended the academic performance indicator (API), which highlighted failing schools using, in part, standardized testing trends. As we discussed previously, the State had to do so because the transition to the new evaluations compromised the comparative ability of test results between local educational agencies. The State fully implemented the dashboard this fall, almost four years after the suspension of the API. However, state law only allows the Superintendent of Public Instruction to intervene in a struggling school district if the district has failed to meet performance standards in three out of four consecutive years. Since dashboard results that will be used to identify districts needing assistance will be first released in the fall of 2017, the earliest intensive intervention cannot occur until three such reports are released, or the fall of 2019.

Consequently, the lapses in accountability measures may limit the State's ability to provide effective oversight of schools, creating a risk that school districts struggling to improve student achievement will continue to spend state funds without adequate accountability or state intervention. Moreover, gaps in the state oversight limit the State's assurance that local educational agencies are spending funds in accordance with the LCFE. For these reasons, we will continue to designate K-12 education a high-risk issue.

### **Because Access and Affordability Issues at UC and CSU Continue, Higher Education Remains a High-Risk Issue**

Our December 2013 report found that access and affordability related to higher education was a high-risk issue because of policy decisions and tuition increases at the UC and CSU systems. Although higher education funding has increased in recent years, UC and CSU continue to have policies that have ultimately limited resident enrollment. Furthermore, after several years with no tuition increases, both UC and CSU will raise tuition for the 2017-18 academic year. In addition, CSU's four-year graduation rates for first-time freshmen remain low, especially in critical fields, adding to the students' time and cost of obtaining a degree. Conversely, the CCC system, through increased funding, has taken steps to increase student enrollment and improve student services at its campuses,

*The lapses in accountability measures may limit the State's ability to provide effective oversight of schools, creating a risk that school districts struggling to improve student achievement will continue to spend state funds without adequate accountability or state intervention.*

and in the absence of other risks, we no longer consider CCC as contributing to the high-risk issue. However, higher education in general remains high-risk because the concerns we identified in our December 2013 report have not been fully resolved and other concerns have emerged.

### ***UC and CSU Continue to Struggle to Provide Access to All Qualified Californians***

California may not be producing an adequate number of college graduates to meet future economic demand. According to a 2015 report from the Public Policy Institute of California, by 2030 the State will need to produce an additional 1.1 million college-educated workers above the current pace in order to meet the demands of future skilled jobs. Although the number of resident students enrolled on UC and CSU campuses has increased since our December 2013 report, more needs to be done.

Beginning in fiscal year 2013–14, the State increased funding to UC and CSU, in part to increase the number of resident students admitted to their campuses. Despite this increase, UC and CSU continue to have policies that limit access to qualified California applicants. For instance, CSU continues to declare *impaction* at most of its campuses, stating that funding increases have not been adequate to fund additional student demand. There are two types of impaction: *campus impaction* occurs when the number of qualified applicants to a campus exceeds available space, *program impaction* occurs when the number of qualified applicants to a particular educational program exceeds available space. Impaction at CSU limits enrollment of first-time freshmen students or college transfers into one or more of its campuses or programs. As part of the 2017–18 Budget Act, CSU will be required to redirect all qualified state applicants who are not accepted to the CSU campus of their choice to a campus that has space but, as indicated in Table 3, only six of the 23 CSU campuses currently have no impaction, and one of those, the CSU Maritime Academy, only offers maritime-related majors. The 17 remaining campuses have either campus impaction or impaction in some or all programs.

***CSU will be required to redirect all qualified state applicants who are not accepted to the CSU campus of their choice to a campus that has space, but only six of the 23 CSU campuses currently have no impaction, and one of those, the CSU Maritime Academy, only offers maritime-related majors.***

With the majority of its campuses impacted, the CSU system appears unlikely to be able to accommodate all eligible resident students. Specifically, the total freshman enrollment for the five unimpacted campuses with nonmaritime majors in academic year 2016–17 was just over 6,650. For that same year, CSU denied admission to about 21,000 eligible residents—more than three times the number of freshmen admitted to the five unimpacted campuses. Assuming enrollment remains relatively steady, it is unlikely that these five campuses will be able to accommodate all of the

redirected applicants. Therefore, if CSU does not increase capacity at its campuses, any redirection policy will result in only a small percentage of redirected students actually enrolling.

**Table 3**  
**Admissions Impaction for First-Time Freshmen Applicants**  
**Academic Years 2013–14 Through 2017–18**

CSU CAMPUS	ADMISSIONS IMPACTION FOR FIRST-TIME FRESHMEN APPLICANTS BY ACADEMIC YEAR				
	2013–14	2014–15	2015–16	2016–17	2017–18
Bakersfield	No	No	No	No	No
Channel Islands	No	No	No	No	No
Chico	Yes	Yes	Yes	Yes	Yes
Dominguez Hills	No	No	No	No	No
East Bay	No	No	No	No	No
Fresno	Yes	Yes	Yes	Yes	Yes
Fullerton	Yes	Yes	Yes	Yes	Yes
Humboldt	Yes	Yes	Yes	Yes	Yes
Long Beach	Yes	Yes	Yes	Yes	Yes
Los Angeles	Yes	Yes	Yes	Yes	Yes
CSU Maritime Academy*	No	No	No	No	No
Monterey Bay	No	No	Yes	Yes	Yes
Northridge	Yes	Yes	Yes	Yes	Yes
Pomona	Yes	Yes	Yes	Yes	Yes
Sacramento	Yes	Yes	Yes	Yes	Yes
San Bernardino	Yes	Yes	Yes	Yes	Yes
San Diego	Yes	Yes	Yes	Yes	Yes
San Francisco	Yes	Yes	Yes	Yes	Yes
San José	Yes	Yes	Yes	Yes	Yes
San Luis Obispo	Yes	Yes	Yes	Yes	Yes
San Marcos	Yes	Yes	Yes	Yes	Yes
Sonoma	Yes	Yes	Yes	Yes	Yes
Stanislaus	No	No	No	No	No
<b>Impacted Campuses†</b>	<b>16</b>	<b>16</b>	<b>17</b>	<b>17</b>	<b>17</b>
<b>Unimpacted Campuses</b>	<b>7</b>	<b>7</b>	<b>6</b>	<b>6</b>	<b>6</b>

Sources: CSU Office of the Chancellor and CSU Maritime Academy website.

\* CSU Maritime Academy offers maritime-related majors only.

† These campuses have experienced impaction in some or all programs.

The UC system has also struggled to maintain access for resident students. In our March 2016 report, *The University of California: Its Admissions and Financial Decisions Have Disadvantaged California Resident Students*, Report 2015-107 (March 2016 report), we found that UC made efforts to enroll more nonresident students who pay

***UC recently implemented a policy change that caps the number of nonresident students at 18 percent of the total enrollment at most UC campuses; however, this cap exceeds the percentage of enrolled nonresidents that we identified in our March 2016 report, which was about 15 percent systemwide.***

higher annual tuition and mandatory fees compared to residents. Specifically, from academic years 2010–11 through 2014–15, total nonresident enrollment at the UC system increased by 82 percent while resident enrollment decreased by 1 percent. Moreover, if residents are eligible for admission and the campuses of their choice do not offer them admission, the UC offers them a spot at an alternative campus—currently limited to Merced—through what it calls a *referral process*. Our March 2016 report noted that the percentage of residents referred to an alternate campus increased by 79 percent from academic years 2005–06 through 2014–15. However, very few residents enroll at the campus to which they are referred. In fact, only 2 percent of resident students referred in academic year 2014–15 actually enrolled. UC recently approved its *Merced 2020* plan to build new academic, residential, and student services space, which it stated will enhance Merced’s desirability and its ability to offer a broader range of academic and co-curricular programs. However, at this time it is unclear whether this project will notably increase the number of residents enrolled in the UC system.

UC also recently implemented a policy change that caps the number of nonresident students at 18 percent of the total enrollment at most UC campuses; however, this cap exceeds the percentage of enrolled nonresidents that we identified in our March 2016 report, which was about 15 percent systemwide. This new policy also allows those campuses that currently enroll more than 18 percent nonresidents to retain their academic year 2017–18 enrollment level as a future cap. Those campuses that enrolled more than 18 percent in academic year 2015–16 were Berkeley (24.4 percent), Irvine (18.9 percent), Los Angeles (22.8 percent), and San Diego (22.9 percent). The policy also states that the remaining campuses will be able to increase their percentage of nonresident enrollment up to 18 percent. Because our March 2016 report concluded that UC’s admission decisions already disadvantaged resident students in part because of the increasing enrollment of nonresidents, it seems unlikely that a cap on nonresident enrollment that allows for additional increases will address the problems we identified.

Additionally, from academic year 2005–06, the UC increased mandatory fees—base tuition and the student services fee—for residents six times and at varying rates, resulting in an overall increase of 99 percent, from \$6,141 in academic year 2005–06 to \$12,240 in academic year 2015–16. After holding tuition steady for a number of years, the UC recently voted to end the tuition freeze and will increase tuition for resident students by about 2.5 percent to \$12,630 for academic year 2017–18. Tuition for nonresident students as well as graduate students will also increase. Our March 2016 report concluded that UC had not conducted a usable study to determine the costs of educating its students, thereby limiting its ability to appropriately justify tuition increases. In 2017 the Legislature passed Assembly Bill 1655 that will require UC to create a cost study using publicly available financial information. Until this report is produced, our concern related to

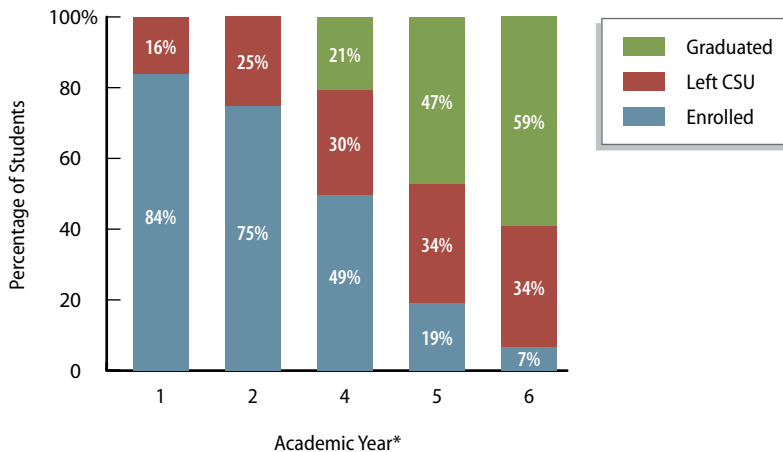


tuition increases at UC remains. Similarly, after six consecutive years of holding tuition steady, the CSU system also recently increased tuition by about 5 percent (from \$5,472 to \$5,742) for academic year 2017–18. In our April 2017 report, *California State University: Stronger Oversight Is Needed for Hiring and Compensating Management Personnel and for Monitoring Campus Budgets*, Report 2016-122, we found that, without more informed oversight of the CSU’s expenditures, the State cannot evaluate whether the CSU’s tuition increases are justified.

**Despite Recent Improvements, CSU’s Four-Year Graduation Rate Remains Low**

CSU’s four-year graduation rates have improved in recent years, but most students still take longer than four years to receive a diploma. Taking extra time to earn a degree is costly for students and for the State. The longer students are enrolled in college, the more they pay for tuition, fees, books, and other education-related expenses, and the greater the delay in entering the workforce. When students take longer to earn their degrees, the State forgoes increased tax revenue from their higher earnings and fewer new students can be served because of limited capacity in the higher education system. At the time of our December 2013 report, fewer than 20 percent of CSU students graduated in four years, and more than 50 percent took six years to earn a CSU degree. CSU has moved to increase graduation rates through its Graduation Initiative, which aims to improve graduation rates and cut achievement gaps between different student groups. However, despite its efforts, the most recent four-year graduation rate at CSU was still 21 percent overall, as shown in Figure 9.

**Figure 9**  
**Systemwide CSU Graduation Rates—2010 Cohort**



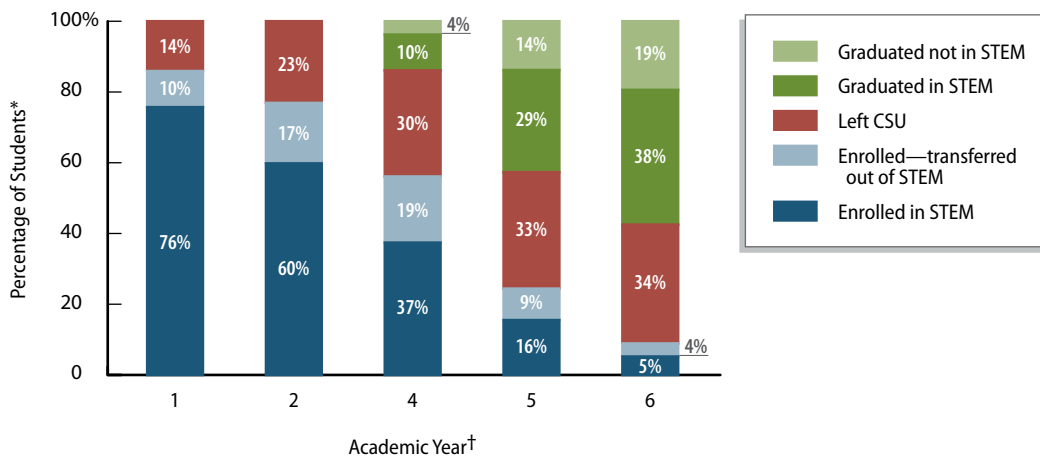
Source: California State Auditor’s analysis of data obtained from the California State University Graduation Rates Consortium for Student Retention Data Exchange.

Note: This cohort data pertains to first-time, full-time freshmen students.

\* Data for academic year 3 are not available.

In addition, four-year graduation rates in fields of study critical to the future workforce needs of the State, such as science, technology, engineering, and mathematics (STEM) fields, are even lower. STEM-related job areas are among the fastest growing in California and typically provide higher wages and a better quality of life to employees. However, according to a 2016 The Campaign for College Opportunity report, California ranks toward the bottom in STEM degree completion rates and may not meet the demands of the future job market. Although CSU’s number of four-year and six-year graduates have shown some improvement since 2013, only 10 percent of new STEM students graduate within four years, as Figure 10 demonstrates.

**Figure 10**  
Systemwide CSU STEM Graduation Rates—2010 Cohort



Source: California State Auditor’s analysis of data from the California State University Graduation Rates Consortium for Student Retention Data Exchange.

Note: This cohort data pertains to first-time, full-time freshmen students.

\* The sum of percentages for each academic year may not equal 100 percent due to rounding.

† Data for academic year 3 are not available.

Moreover, some CSU campuses perform worse than this average. For example, one campus’s four-year graduation rate for all majors is less than 10 percent; and for students pursuing STEM degrees, four-year graduation rates are less than 3 percent. According to CSU’s assistant vice chancellor for student success and strategic initiatives, barriers toward students completing degrees in a timely manner include financial concerns, unplanned interruptions in academic coursework, and the availability of required courses at the right time. Furthermore, because of the many sequential requirements for a STEM degree, completing necessary courses slows student progress, which leads to a lower timely graduation rate.

### ***Increased Funding Has Helped CCC to Better Serve Students***

CCC funding has increased since 2013 and is no longer an immediate risk to the system's ability to provide courses and services to students. Our December 2013 report noted that the State reduced funding to CCC, making it more difficult for students to take the courses they need, thereby restricting their ability to complete a degree, earn a certificate, or transfer to another institution. Subsequent to the December 2013 report, the State has increased funding to CCC from about \$3.9 billion to more than \$5.7 billion in fiscal year 2017–18. This increased funding has allowed CCC to hire more staff and increase its spending on academic support and program offerings—including limited bachelor degree programs—and increase the number of students transferring to the UC and CSU systems.

Data from UC and CSU show that over a four-year period, the number of students transferring from CCC to a UC or CSU campus has increased by 18 percent and 21 percent, respectively. Specifically, in the fall of 2013, about 21,000 community college students enrolled at a UC campus, and four years later, that number has increased to almost 24,700. Similarly, the CSU reported that in the fall of 2016, it enrolled roughly 8,500 more CCC transfer students than it did in the fall of 2012.

Because CCC has the ability to sustain its operations and has made efforts to improve its services and academic offerings and to increase the number of students transferring to the UC and CSU systems, we no longer consider CCC to be an element of the high-risk issue of education.

### **Agency Comments**

#### ***K–12 Education***

Education does not agree with the conclusions in our assessment. In particular, Education does not agree that its oversight has been inadequate because LCFF specifically delegated matters to local school district control or to County Offices of Education. However, Education misunderstands our concerns. Specifically, we concluded that the shift to LCFF has created gaps in accountability because, as our February 2017 audit on the college readiness of California students found, LCAPs were often inaccurate or vague and provided little value in terms of evaluating district performance. Given that Education is charged with overseeing the State's public schools and enforcing education laws and regulations, we continue to believe Education should take additional steps to increase school accountability.

In another example, Education stated that it identified 228 districts for differentiated assistance with the release of its fall dashboard. Thus, according to Education, our conclusion that the earliest intervention cannot occur until the fall of 2019 is not accurate. However, we obtained reports from Education's website that clearly state that the earliest intervention cannot occur until 2019. Our concern relates to *intervening* with struggling school districts rather than *identifying* struggling school districts, thus we do not agree that Education has eliminated our concerns simply because it has identified 228 districts for assistance.

In a final example, Education asserted that we did not take the opportunity to follow up with its staff after our exit conference. Counter to this assertion, we made several changes to the report following our exit conference in October 2017 based on the feedback that Education provided and our follow up with its staff. Thus, Education's claim is not accurate.

### ***Higher Education***

In its response to our draft report, the CSU stated that it continues to improve graduation rates and eliminate equity gaps, but that additional state funding is needed to produce more college graduates. The CSU added that, absent additional state investment, it must continue to utilize impaction policies that limit enrollment in high-demand programs and campuses.

In its response, the UC noted that because of increased enrollment growth funding provided by the Legislature and Governor, it has enrolled 10,900 more California resident undergraduates since the fall of 2014. The UC also stated that its policy that caps the number of nonresident students satisfies the Legislature's requirements included in the Budget Act.

CCC did not provide written comments to our draft report.

# CHAPTER 5

## Sound Fiscal Policy and Decision Making

HIGH-RISK ISSUE	RESPONSIBLE AGENCY
<b>CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM (CALSTRS)</b>	
The additional funding approved to finance the pension liabilities of CalSTRS' Defined Benefits Program is not expected to decrease the pension plan's unfunded liability until fiscal year 2029–30, and the plan is susceptible to investment return volatility, changes in actuarial assumptions, and statutory limitations on the State's contributions.	CalSTRS
<b>OTHER POSTEMPLOYMENT BENEFITS (OPEB)</b>	
Although the State has initiated its plan to eliminate its unfunded liability for OPEB, it is in the early stages and the issue will take many years to resolve.	Not applicable
<b>STATE BUDGET</b> <i>(no longer a high-risk issue)</i>	
The State's budget condition is no longer a high-risk issue because, among other actions, voters approved legislation that requires the State to increase its rainy-day reserve and pay down state debt.	Not applicable

### The Length of Time Needed to Fully Fund the California State Teachers' Pension Liability Causes It to Remain a High-Risk Issue

CalSTRS provides a comprehensive retirement package to California teachers and other qualified employees. As we described in our September 2013 report, the contributions required from CalSTRS members and their employers were not sufficient to ensure payment of all promised future benefits. We also noted that poor investment returns because of economic recessions, as well as an inability to adjust contributions, had caused the funding ratio of CalSTRS' Defined Benefit Program to decrease significantly. In 2014 the State took legislative action to help further finance the pension liabilities of that program by putting in place an updated funding plan that is projected to fully fund the program by 2046. However, that additional funding is not expected to begin to decrease the pension plan's unfunded liability until fiscal year 2029–30, and the plan is susceptible to investment return volatility, changes in actuarial assumptions, and statutory limitations on the State's contributions. Therefore, the funding of CalSTRS continues to be a high-risk issue for the State.

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. With more than 914,000 members and benefit recipients, CalSTRS is

the largest educator-only pension fund in the world. CalSTRS is responsible for administering the State Teachers' Retirement Plan and its primary program, the Defined Benefit Program, which provides defined retirement benefits based on retirement age, years of service, and compensation totals. In addition to paying the current year's pension obligations, CalSTRS' funding plan is designed to eliminate its unfunded obligation for future pension benefits by setting aside funds each year. The members, their employers, and the State are each required to contribute a percentage of members' salaries to prefund pension benefits for CalSTRS members. The contribution rates are defined in law and require legislative action to change.

Pension systems have very long-lived liabilities, paying promised benefits many decades after they are first offered. Poor investment returns caused by economic recessions, as well as the inability to adjust contributions, had caused the funding ratio of the CalSTRS' Defined Benefit Program to decrease from 98 percent in 2001 to just under 69 percent as of June 30, 2014. As a result, projections indicated that CalSTRS' Defined Benefit Program would have its assets depleted in about 33 years unless additional funding was secured.

In response, the Legislature passed Assembly Bill 1469 that adjusted contribution rates for employees, employers, and the State effective July 1, 2014. As Table 4 shows, this legislation incrementally increases contributions from members, employers, and the State with a goal of eliminating the unfunded obligation by 2046. Additionally, the legislation requires CalSTRS to report to the Legislature every five years as to whether the plan continues to sustain an appropriately funded benefit program. According to the May 2017 Legislative Analyst's update report on CalSTRS funding, this legislation was a major accomplishment. The report noted that while fully funding CalSTRS will mean that taxpayers and teachers will contribute billions more in the next few decades, the plan will lower long-term costs and put CalSTRS on a sustainable path.

Although the new changes are expected to eventually fully fund the Defined Benefit Program, the changes will not result in a decrease in the unfunded liability for several more years. As Figure 11 on page 58 shows, CalSTRS expects the unfunded liability to continue to grow for the next 13 years before it starts to decrease.

Further, changes in the investment return and actuarial assumptions can alter the projected timeline for eliminating the unfunded liability. For fiscal year 2013–14, CalSTRS reported an investment return of 18.66 percent. However, for fiscal years 2014–15 and 2015–16 it reported investment returns of 4.8 percent and 1.4 percent, respectively. According to its 2017 report of funding levels and risk, CalSTRS states that when investment returns are below expectations,

the unfunded actuarial obligation (unfunded liability) increases and additional contributions are needed to bridge the gap. In addition, the CalSTRS board recently approved changes in a number of the assumptions that actuaries use to estimate the unfunded liabilities. Specifically, the board adopted a reduction in the investment return assumption from 7.5 percent to 7.25 percent. This change took effect for the fiscal year 2015–16 valuation and contributed to an increase in the size of the unfunded liability as of June 30, 2016. The CalSTRS board also voted to further reduce the investment return assumption by another 0.25 percent to 7 percent for the June 30, 2017, actuarial valuation, which will be released in spring 2018. Because actuaries project liabilities decades into the future, small changes in the rates result in large changes in the value of estimated liabilities. As a result, the projected liabilities may increase again if further changes are made to lower the investment return assumption.

**Table 4**  
Recent Legislation Increased Contributions to Help Fully Fund the California State Teachers’ Pension Liability

EFFECTIVE DATE	PRIOR RATE OF CONTRIBUTION			REVISED RATE OF CONTRIBUTION			
	ALL MEMBERS	CALSTRS EMPLOYERS	STATE	2% AT 60 MEMBERS	2% AT 62 MEMBERS	CALSTRS EMPLOYERS	STATE
July 1, 2014				8.15%	8.15%	8.88%	3.454%
July 1, 2015				9.20	8.56	10.73	4.891
July 1, 2016						12.58	
July 1, 2017						14.43	
July 1, 2018	8%	8.25%	2.017%			16.28	
July 1, 2019				10.25	9.205*	18.13	6.328 <sup>‡</sup>
July 1, 2020						19.10	
July 1, 2021–June 30, 2046						19.10 <sup>†</sup>	
July 1, 2046						8.25	

Sources: Assembly Bill 1469, Chapter 47, Statutes of 2014, and associated CalSTRS fact sheet.

Note: In addition to the rates shown, the State contributes another 2.5 percent as the purchasing power benefit contribution.

\* This rate can be further adjusted if the CalSTRS board changes, as state law allows, the *normal cost* of benefits, which is the annual cost of providing benefits to active employees for the upcoming fiscal year.

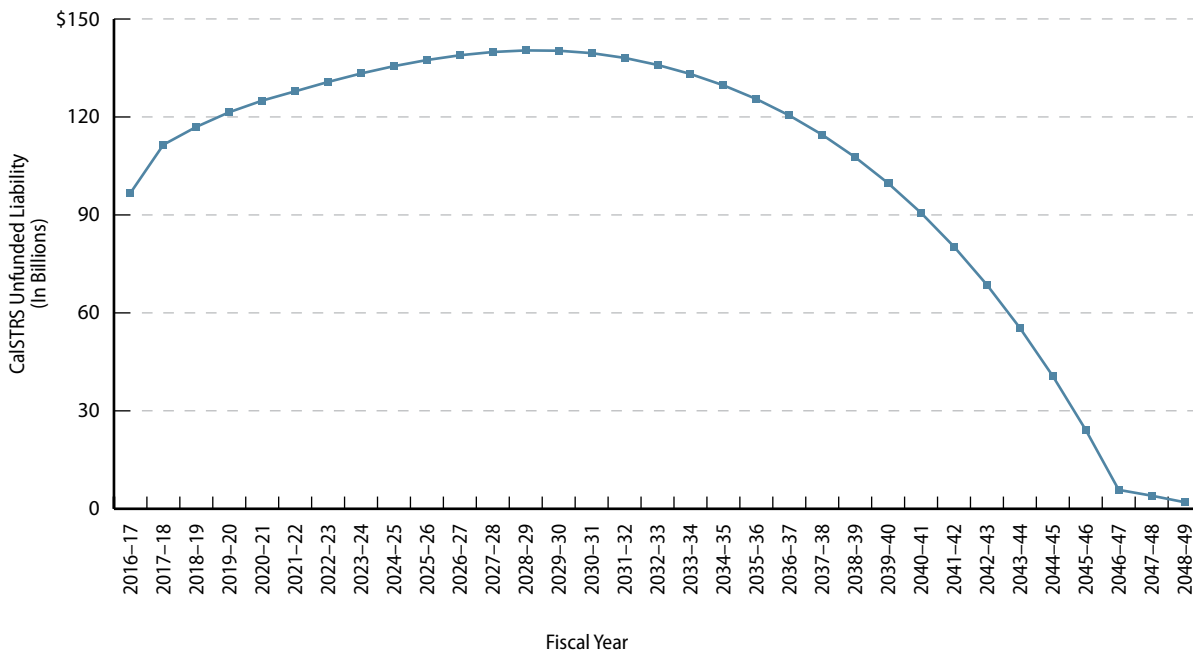
† The CalSTRS board may adjust the contribution rate by up to 1 percent in a fiscal year between July 1, 2021, and June 30, 2046. However, it cannot exceed a maximum of 20.25 percent.

‡ The CalSTRS board has limited authority to adjust state contribution rates from July 1, 2017, through June 30, 2046. The board cannot increase the rate by more than 0.5 percent in a fiscal year and if there is no unfunded liability, the increase in state contribution rate is reduced to zero.

Additionally, the board modified assumptions regarding mortality to account for the increased life expectancy of benefit recipients. As a result of these changes, combined with recent investment returns that were lower than expected and contributions that were insufficient to cover the interest on the unfunded liability during fiscal year 2015–16, the estimate of CalSTRS’ unfunded liability increased from \$76 billion as of fiscal year 2014–15 to \$97 billion as of fiscal year 2015–16.

According to the Legislative Analyst’s report, while recent changes have increased the unfunded liability, these new assumptions better reflect future expected improvements in life expectancy; and combined with the increased contributions mentioned earlier, they will reduce the likelihood that a further increase in the unfunded liability will occur in the future, thus keeping the funding plan on track for full funding.

**Figure 11**  
**Projected Unfunded Liability for CalSTRS Under Newly Authorized Contribution Levels**



Source: Data provided by CalSTRS.

Note: The projected unfunded liability is based on June 30, 2016, actuarial valuation. Under this valuation, the unfunded liability for fiscal year 2016-17 was derived based on an investment return assumption of 7.25 percent. The unfunded liability starting with fiscal year 2017-18 was derived based on an investment return assumption of 7 percent each year.

However, the fact remains that changes in actuarial assumptions can have significant impact on future liabilities. Further, the Legislative Analyst noted considerable concerns with the current funding plan. For example, it stated that CalSTRS’ recent changes in actuarial assumptions potentially exposes the State to a larger unfunded liability than was thought possible when the Legislature passed the new laws regarding funding. Specifically, the increase in the State’s share of the unfunded liability was more than 50 percent greater than it was in 2014. Therefore, to the extent that CalSTRS’ funding situation continues to erode—either through worse-than-assumed investment performance or further changes in actuarial assumptions—the State will largely bear the responsibility for covering the resulting costs.



As time passes, the unfunded pension liability of the Defined Benefit Program is expected to decrease. However, because of the long timeline needed to fully fund the program, the number of actuarial assumptions in the estimates, and the volatility inherent in the investment returns and assumptions, we do not believe sufficient progress has been made to eliminate the program from the high risk list. Thus, CalSTRS' Defined Benefit Program remains a high-risk issue for the State that we will continue to monitor.

### **The State's Substantial Other Postemployment Benefits Liability Remains a High-Risk Issue**

The State has experienced increasing costs for providing OPEB to retirees and their family members. OPEB are additional benefits beyond pensions and include, for example, medical and dental insurance premiums. The State's total accrued OPEB liability—the estimated total cost for all retiree health benefits that will be paid in the future—grew from \$63.8 billion in 2012 to \$76.7 billion in 2016. Historically, the State has primarily used a pay-as-you-go funding method, which pays only for the current year's benefit expenditures. As a result, the State's total accrued OPEB liability grew by more than 20 percent from 2012 to 2016. In 2015 the State acknowledged that the pay-as-you-go funding system for retiree health benefits was not working, and it began implementing a plan to address the unfunded future liability. Although the State has initiated its plan, it is in the early stages and will take many years to resolve. Therefore, the State's OPEB liability continues to be a high-risk issue for the State.

Our September 2013 report concluded that the State's growing OPEB liability remained a high-risk issue in need of continued monitoring. The State provides health benefits (medical and prescription drug benefits) and dental benefits to retirees through a substantive single-employer defined benefit plan to which the State contributes as the employer. The Legislature established the contribution requirements of plan members and the State, and it has the authority to amend these requirements. According to state law, the State generally pays for 100 percent of the health insurance premium cost of retirees, plus 90 percent of the additional premium required for the enrollment of family members of retirees, depending on completed years of credited state service. Similarly, the State generally pays for all or a significant portion of the dental insurance premium cost for retirees, depending upon the completed years of credited state service at retirement and the dental coverage the retiree selects. The State's annual OPEB costs are rising because of a growing number of retirees as well as increases in the cost of health care premiums. The number of retirees grew from approximately 144,000 in fiscal year 2011–12 to more than 149,000 in fiscal year 2015–16—an increase of almost 4 percent. Over the same period, average health

*The State's total accrued OPEB liability—the estimated total cost for all retiree health benefits that will be paid in the future—grew from \$63.8 billion in 2012 to \$76.7 billion in 2016.*

*The growth in the number of retirees and increases in the cost of average health care premiums, resulted in a 5 percent increase in annual OPEB expenditures.*

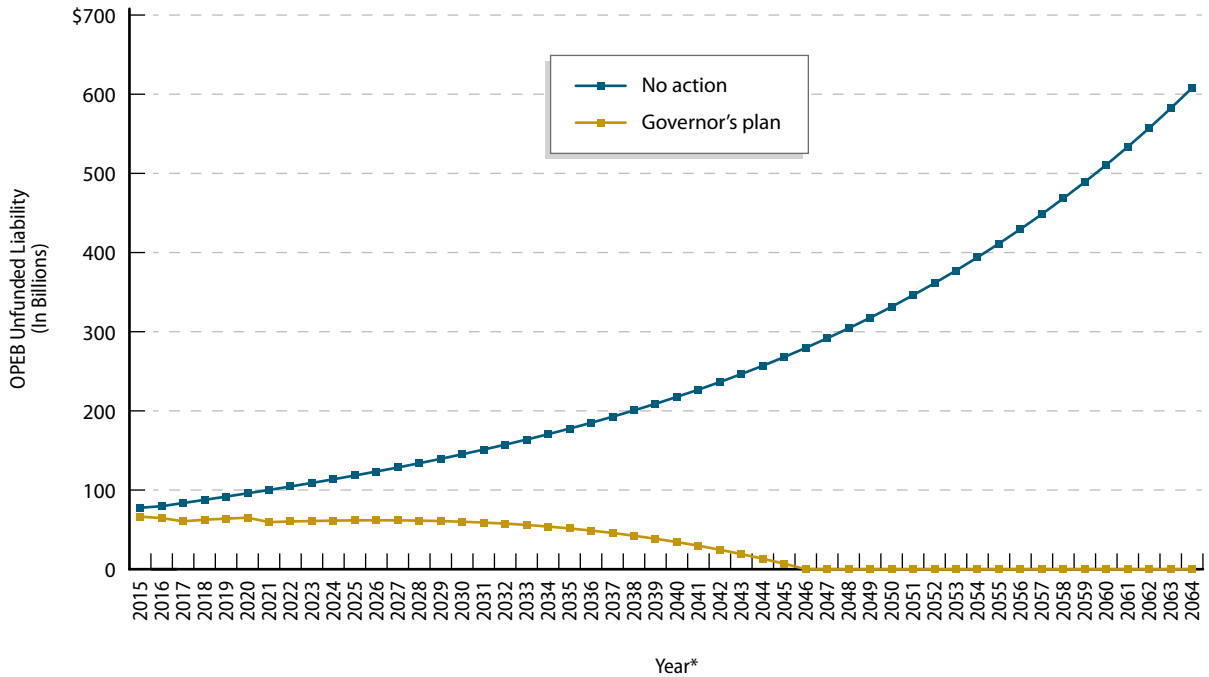
care premiums rose by 25 percent. These two factors resulted in a 5 percent increase in annual OPEB expenditures, from \$1.47 billion in fiscal year 2011–12 to \$1.55 billion in fiscal year 2015–16.

Each year the State determines its annual OPEB contribution, which is an actuarially determined level of funding that is projected to cover the current year's cost of benefits and is the required minimum annual amount, as well as a portion of the future unfunded liability. However, because the State has historically funded the cost of providing health and dental insurance to retirees by paying only the annual required contribution, the pay-as-you-go basis, the State's total accrued liability—the estimated total for all retiree benefits that will be paid in the future—has grown from \$63.8 billion in 2012 to \$76.7 billion in 2016. The Governor's Budget Summary for fiscal year 2015–16 acknowledged that the pay-as-you-go system for funding retiree health benefits was not working and initiated a prefunding strategy to fully fund the program. The budget summary estimated that without taking action to change the funding process, the State's unfunded liability would grow to \$100 billion by 2020–21 and \$300 billion by 2047–48, as shown in Figure 12.

The 2015–16 Governor's Budget called for the State and its employees to share equally in the prefunding of retiree health benefits. The Governor's plan was to phase in this critical strategy through cost-sharing agreements as labor contracts come up for renewal. Specifically, the plan looked to increase contribution amounts from employees and modify benefit packages offered to future retirees. Additionally, under this plan, investment returns would help pay for future benefits, just as with the State's pension plans, to eventually eliminate the unfunded liability by fiscal year 2044–45. Further, the summary noted that this approach would save nearly \$200 billion over the next 50 years.

According to the May Revision for the 2017–18 Governor's Budget, collective bargaining has concluded and the State's administration has negotiated successor contract agreements with all bargaining units. The Governor's May Revision noted that through this process, the State successfully addressed and implemented the strategy necessary to address the \$76.7 billion unfunded liability for retiree health benefits. The May Revision also noted that as a result, more than \$470 million is currently set aside in the prefunding trust fund to pay for future retiree health benefits and that by the end of fiscal year 2017–18, the trust fund balance will approach \$1 billion in assets. Though this represents significant progress, it will take many years to reduce the unfunded liability. Consequently, the State's substantial OPEB liability remains a high-risk issue in need of continued monitoring.

**Figure 12**  
**Projected Unfunded Liability for OPEB for Retiree Health Care**



Source: Data obtained from the Department of Finance.  
\* Unfunded liability valuation occurs on July 1 of each year.

**The State’s Budget Condition Is No Longer a High-Risk Issue**

In our September 2013 report, we noted that the State’s budget condition remained a high-risk issue. Since that report, voters approved legislation that created new rules for the budget process, including paying down debt and increasing the State’s budget reserve. Additionally, the 2017–18 Governor’s Budget was the seventh consecutive budget to be enacted on time. As a result, the State’s budget condition no longer represents a substantial risk of serious detriment.

In 2014 voters approved Proposition 2, which changed the State’s budget practices concerning reserves and debt payments by amending the California Constitution (Constitution) to implement new rules for minimum annual deposits into the Budget Stabilization Account, also known as the State’s *rainy-day fund* or *reserve*. Beginning in fiscal year 2015–16, the State is to put aside a minimum amount to be deposited in the Budget Stabilization Account. This minimum amount is composed of 1.5 percent of the State’s General Fund revenues for that fiscal year plus a portion of revenues from personal capital gains taxes that exceed a specified threshold. One half of the minimum deposited amount is allocated to build the rainy-day fund and the other half is allocated to pay down state debt. Specifically, Proposition 2 established a constitutional goal of having 10 percent of tax revenues in the rainy-day fund.

*As of June 30, 2016, the rainy-day fund had a balance of \$3.4 billion, while the fiscal year 2016–17 budget projected a balance of \$6.7 billion, resulting in the fifth consecutive year of projected budget surplus in the General Fund.*

As of June 30, 2016, the rainy-day fund had a balance of \$3.4 billion, while the fiscal year 2016–17 budget projected a balance of \$6.7 billion, resulting in the fifth consecutive year of projected budget surplus in the General Fund. According to the Governor’s May Revision for the fiscal year 2017–18 budget, the State’s rainy-day fund will have a total balance of \$8.5 billion by June 30, 2018, which is 66 percent of the constitutional goal. While a full rainy-day fund might not eliminate the need for further spending reductions in the event of a recession or of major federal policy changes that trigger a budget crisis, saving now will allow the State to spend from its rainy-day fund later to lessen the magnitude and length of any necessary cuts.

In addition to mandating minimum deposits into the rainy-day fund, Proposition 2 established new rules regarding annually paying down the State’s debt. Specifically, it requires the Legislature to appropriate funds dedicated to paying down state debt for one or more of four defined obligations and purposes: (1) unfunded prior fiscal year General Fund obligations; (2) budgetary loans to the General Fund, from funds outside the General Fund, that had outstanding balances on January 1, 2014; (3) certain payable claims for mandated costs incurred before fiscal year 2004–05 that remain unpaid; and (4) unfunded liabilities for state-level pension plans and prefunding of OPEB, in excess of current base amounts as established for the fiscal year in which the funds would otherwise be transferred to the rainy-day fund.

Finally, the State has taken steps to improve the timeliness of enacting the state budget. In 2010 California voters approved Proposition 25, which changed the legislative vote requirement for passing the budget and budget-related legislation from two-thirds to a simple majority of each house of the Legislature. Additionally, this proposition requires legislators to pass a budget bill by June 15 or forfeit salaries and expense reimbursements for every day that a budget bill is not passed after this deadline. The Legislature has passed the budget by the deadline for each of the last seven years starting with fiscal year 2011–12. The State’s continued timeliness of approving budgets shows consistent progress regarding the budget process.

### **Agency Comments**

In its response to our assessment, CalSTRS provided some suggested edits to further clarify our report text. Although we have made those edits, our assessment of high risk did not change. Because OPEB and the state budget affect, and are affected by, nearly every state agency, we did not request agency comments on these two sections of the draft report.

# CHAPTER 6

## The State’s Workforce and Succession Planning

HIGH-RISK ISSUE	RESPONSIBLE AGENCY
<b>WORKFORCE AND SUCCESSION PLANNING</b>	
<p>CalHR has developed and executed a pilot program to assist agencies in developing workforce plans; however, it still needs to finalize and assess the effectiveness of its approach to aiding agencies in their planning efforts.</p>	<ul style="list-style-type: none"> <li>• California Department of Human Resources (CalHR)</li> <li>• State agencies</li> </ul>
<p>CalHR reported that only 29 of 123 surveyed agencies had completed workforce and succession plans, as of December 2017. Therefore, the State is still at risk that numerous agencies are not adequately prepared for impending retirements.</p>	

### CalHR’s Process to Aid Agencies in Workforce and Succession Planning Is New and a High Number of Agencies Lack Completed Plans

The State continues to face challenges related to its workforce and succession planning as the percentage of employees approaching retirement age remains high. Since 2007 we have included workforce and succession planning on our list of statewide issues that pose a risk to the State, primarily because the segment of the State’s workforce age 50 or older has been consistently high—hovering between a low of 37.5 percent as of the end of fiscal year 2007–08 and a high of 41 percent in fiscal year 2012–13. According to the CalHR website, as of December 2017, only 29 out of 123 state agencies have completed workforce and succession plans. Such plans provide agencies with the ability to forecast future workforce needs; to develop strategies to ensure that they have a talented, competent workforce; and to mitigate the loss of institutional knowledge through attrition. As we indicated in previous high-risk reports, it is particularly critical to engage in workforce and succession planning when large proportions of an organization are eligible to retire at roughly the same time, which continues to be a concern for California state government. Should the State experience a sudden wave of retirements, it is at substantial risk of experiencing impaired delivery of important government services or a significantly reduced overall effectiveness or efficiency of state government programs. Although certain state agencies we previously reviewed have developed and implemented plans that will better prepare them for these impending retirements, CalHR is still determining how best to assist state agencies in their planning efforts and numerous agencies have yet to develop workforce and succession plans. Until CalHR finalizes and assesses the effectiveness of its approach to aiding state agencies in their planning efforts and those state agencies that lack workforce and

succession plans make it a priority to develop and complete such plans, the potential loss of institutional knowledge remains at high risk.

In our May 2015 report, *High Risk: State Departments Need to Improve Their Workforce and Succession Planning Efforts to Mitigate the Risks of Increasing Retirements*, Report 2015-608, we included a review of CalHR, which is uniquely positioned, though not expressly authorized or required, to oversee workforce and succession planning across state government. In that report, we concluded that CalHR had missed opportunities to provide consistent guidance to strengthen state agencies' workforce and succession plans. Consequently, we made several recommendations to CalHR related to improving the consistency and quality of the guidance it provides state agencies. For example, we recommended that CalHR develop a process to periodically evaluate and update its workforce and succession planning materials, better promote its resources and tools, and survey state agencies to determine how they perceive the effectiveness of the resources and tools CalHR makes available to them. Further, we recommended that CalHR annually obtain workforce and succession plans from all agencies, starting in 2016, as well as any updates and the implementation status of those plans. Additionally, we followed up on the planning and evaluative efforts of three agencies we had previously reviewed—the California Governor's Office of Emergency Services (Office of Emergency Services), Social Services, and Caltrans—and concluded that their efforts could be strengthened to help ensure that they are ready to address the risks that upcoming retirements pose. As a result, we recommended that these state agencies develop a process to evaluate their workforce and succession plans. Based on our review of documentation from the Office of Emergency Services, Social Services, and Caltrans, we found that they have fully implemented our recommendations and therefore, have taken steps to ensure that they are prepared to address that risk.

***Although CalHR has taken steps to inform and help state agencies mitigate the potential effects of mass retirements, some of these efforts are new, and a recent CalHR survey indicates that numerous state agencies have not developed workforce and succession plans.***

Although CalHR has taken steps to inform and help state agencies mitigate the potential effects of mass retirements, some of these efforts are new, and a recent CalHR survey indicates that numerous state agencies have not developed workforce and succession plans. For example, in response to our recommendation that CalHR annually obtain workforce and succession plans from all agencies, CalHR instituted a policy effective February 2017 that requires state agencies to have workforce and succession plans. However, CalHR recently learned that many state agencies are not adequately prepared for impending retirements. Specifically, in June 2017, CalHR requested that all state agencies respond to a survey regarding the status of their plans and subsequently submit those plans for review. CalHR published a list of the status of all agencies' workforce and succession plans on its website in October 2017.

According to this listing, as of December 2017, just 29 of 123 agencies surveyed had completed workforce and succession plans. Specifically, three agencies had outdated plans, 31 were in progress, 19 had not yet begun their planning efforts, and the remaining 41 agencies did not respond to the survey at all.

The manager of CalHR's statewide workforce planning and recruitment unit (manager of workforce planning) told us that CalHR uses state agencies' plans collectively to inform and drive its statewide planning efforts. The agency-level plans are the primary source of information that CalHR depends on to not only evaluate the statistics of workforce planning throughout civil service but also to identify trends across organizations. In addition, CalHR develops statewide planning tools and resources in response to the identified trends. The manager of workforce planning explained that workforce planning is the responsibility of each agency and CalHR has developed training and provided tools, and it makes its staff available to assist agencies in developing their plans. Given CalHR's efforts to inform state agencies about the importance of workforce planning and the small number of state agencies that have actually completed plans, CalHR agrees that workforce planning continues to be of high importance to the State overall.

Further, in January 2017, CalHR began a multi-month pilot program to assist selected state agencies in developing workforce plans. According to the manager of workforce planning, CalHR initiated its pilot program with all the departments, boards, and commissions within the California Business, Consumer Services and Housing Agency and the California Department of General Services (General Services). Regarding participation in the pilot program, she stated that the Business, Consumer Services and Housing Agency recognized the importance of workforce planning and the criticality of each of its nine departments, boards, and commissions, and it ensured the commitment of resources by each participating entity under the agency's purview. She further explained that CalHR extended an invitation to General Services because it was one of the few remaining organizations within the California Government Operations Agency without a standing workforce plan. The purpose of the pilot program is to guide agencies through the workforce planning process over five to six months culminating with a completed workforce plan. According to CalHR, this first cohort completed its training at the end of May 2017 and the 11 state departments, boards, and commissions now have workforce plans. CalHR's manager of workforce planning noted that this pilot program also provides it with the opportunity to use, evaluate, and refine the tools and guidance it provides to state agencies. Additionally, CalHR is still assessing how many agencies it can include in the future workforce planning training program annually, and it is planning to develop a companion succession planning training by the end of December 2017.

*Of the agencies surveyed, three had outdated plans, 31 were in progress, 19 had not yet begun their planning efforts, and the remaining 41 agencies did not respond to the survey at all.*

***The second most common workforce challenge was associated with employee compensation, particularly with salary disparities between state and local government positions.***

In response to our previous high-risk reports concerning the State's efforts to manage the risks associated with a potential mass exodus of experienced employees and in an effort to provide greater support to statewide workforce planning efforts, in 2015 CalHR began conducting one-on-one interviews with directors from 116 agencies to identify the workforce challenges that most concerned these state leaders. CalHR summarized the results of these interviews in its 2016 report, *Statewide Workforce Planning Report: An Analysis of Agency and Department Interview Findings*. When asked about the greatest workforce challenges, the most common agency response was recruiting and hiring employees with the competencies needed to succeed in public service jobs. The interviewed agency directors suggested that the arduous civil service hiring process is discouraging top talent from applying for positions with the State. However, CalHR and the State Personnel Board have undertaken initiatives to improve the hiring process, such as streamlining the State job search website called *CalCareers*, consolidating civil service classifications, and expanding the ability of state agencies to use an exam process that ensures that qualified candidates are immediately reachable on employment eligibility lists.

The second most common workforce challenge was associated with employee compensation, particularly with salary disparities between state and local government positions. Some directors explained that highly qualified employees are leaving critical positions to work in jobs in local government with higher pay and less responsibility. As for succession planning, the agency directors questioned whether their organizations are adequately prepared for the loss of knowledge and expertise that will result from impending retirements. An even greater immediate concern pertains to whether their leadership teams possess sufficient skills and experience to take on this increased responsibility.

In its 2016 report, CalHR concluded that it would use the findings to create a statewide workforce plan that would include strategies for how the State can address workforce challenges that are common across its multiple organizations. When we inquired about when CalHR expected to complete such a statewide workforce plan, in contrast to the statement in its report, the manager of workforce planning clarified that CalHR's 2016 report is its first statewide workforce plan. She explained that the structure of this workforce plan will differ from an agency-level workforce plan in that it identifies current workforce challenges as well as suggested paths forward at the department and control agency level. CalHR intends to update the statewide plan annually. The manager of workforce planning explained that as of June 2017, CalHR is still developing the methodology and format for updating the statewide plan for 2017 and does not yet have an anticipated issue date. Although the efforts CalHR has taken in response to our recommendations



demonstrate a strong commitment to corrective action, the large number of state agencies that have not completed workforce and succession plans indicates that the risk remains that the State is not sufficiently prepared for impending retirements and the resulting loss of institutional knowledge.

### **Agency Comments**

CalHR stated that because there continues to be a high percentage of state employees at or near retirement age and, because state agencies are struggling to deal with a host of other workforce challenges, it agrees that workforce and succession planning needs to be a high priority. CalHR explained that it has scheduled additional workforce planning trainings that will accommodate a total of 24 agencies annually, and has launched a companion pilot program for succession planning that it anticipates will accommodate 20 agencies annually. CalHR added that it has also made improvements to its online workforce planning tools and resources to further support and empower agencies to develop their plans with minimal direct involvement from CalHR.

We prepared this report under the authority vested in the California State Auditor by Section 8546 of the California Government Code.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

Date: January 18, 2018

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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 A

## CONSIDERATIONS FOR DETERMINING HIGH RISK

Government Code section 8546.5 provides the State Auditor 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, that the State Auditor 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 State Auditor, to consult with the Legislative Analyst's Office, the Little Hoover Commission, the Office of the Inspector General, the Department of Finance, and other state agencies with oversight responsibilities.
- To issue audit reports with recommendations for improvement 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 State Auditor on the status of recommendations for improvement made by the State Auditor or other state oversight agencies.

In addition, section 8546.5 requires the State Auditor 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 2016 the State Auditor adopted regulations to implement, interpret, and make specific the provisions of the state high risk authority (Title 2 Cal. Code. Regs. sec. 61000 et seq.) These regulations provide the criteria we use in establishing the state high risk list and whether a state agency or statewide issue will remain on the list. In determining whether a state agency or statewide

issue should be identified as high-risk, we consider a number of qualitative and quantitative factors in addition to the criteria we detailed in the Introduction. Although we consider many qualitative factors, we focus in particular on whether the risk could result in significantly impaired service; 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. We also assess different factors in determining the substantiality of risk, including whether the risks are already causing detriments to the State or its residents, whether those risks are escalating, and whether changes in circumstances are likely to cause detriment.

### **Responsiveness to Recommendations and Corrective Measures**

Government Code section 8546.2 requires that state agencies provide the State Auditor with updates on the implementation of recommendations we have made to them both in the form and at the intervals prescribed by the State Auditor. Moreover, Government Code section 8548.9 places additional reporting requirements on state agencies that have not implemented audit recommendations that are more than one year old.

The State Auditor also receives whistleblower complaints about improper governmental activities under the California Whistleblower Protection Act (Government Code section 8547 et seq.) 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 audited or investigated state agency 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 to taking corrective measures stemming from investigations may include additional follow-up reviews by the State Auditor and ultimately is based on our professional judgment.

### **Ongoing Reporting and Future Audits**

Once the State Auditor identifies a state agency or statewide issue as being high-risk, the State Auditor may require the affected agencies to report on the status of those recommendations for improvement made by the State Auditor or other state oversight agencies. Related to that, the State Auditor may require affected agencies to periodically report their efforts to mitigate or resolve the risks identified by the State Auditor or other state oversight agencies. In addition, the State Auditor 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, we may remove the designation under the following circumstances: (1) if there is a change in circumstances that results in the risk no longer presenting a serious detriment and (2) if there is a demonstrated commitment by the leadership of the state agency or agencies responsible for addressing the risk. The state agency or responsible agencies should define the root causes of the risk and identify effective measures for eliminating those causes. 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 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 is based on our professional judgment.

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## APPENDIX B

### CALIFORNIA STATE AUDITOR'S SURVEY OF SELECT ENTITIES FOR LEVELS OF COMPLIANCE WITH SECURITY STANDARDS

We resurveyed 101 state entities that certified their levels of compliance with the requirements in Chapter 5300 of the *State Administrative Manual* (security standards) to the California Department of Technology (Technology Department) in 2014.<sup>5</sup> These state entities were previously surveyed for our August 2015 report. In an effort to protect the State's information assets, we have chosen not to publicly disclose the names of the entities that we surveyed; instead, we assigned each entity a number. In Table B beginning on the following page, we summarize the 87 respondents' self-reported levels of compliance with 17 security standards that we placed into the following categories: Information Asset Management, Risk Management, Information Security Program Management, Information Security Incident Management, and Technology Recovery. We grouped the remaining security standards into the category of Other Information Security Requirements. In addition, Table B identifies the types of information some respondents asserted that they collect, store, or maintain. Other respondents stated that they did not have such information.

<sup>5</sup> The 101 state entities we surveyed included entities that state law requires to report to the Technology Department each year as well as some entities that voluntarily reported to the Technology Department in 2014.





STATE ENTITY	COLLECTS, STORES, OR MAINTAINS*			SELF-REPORTED COMPLIANCE LEVELS					
	PERSONAL INFORMATION OR HEALTH INFORMATION PROTECTED BY LAW	CONFIDENTIAL FINANCIAL DATA	OTHER SENSITIVE DATA	INFORMATION ASSET MANAGEMENT	RISK MANAGEMENT	INFORMATION SECURITY PROGRAM MANAGEMENT	INFORMATION SECURITY INCIDENT MANAGEMENT	TECHNOLOGY RECOVERY	OTHER INFORMATION SECURITY REQUIREMENTS
38									
39	Yes		Yes						
40	Yes								
41									
42									
43									
44									
45	Yes	Yes							
46	Yes								
47	Yes	Yes							
48	Yes								
49	Yes		Yes						
50	Yes	Yes							
51									
52	Yes		Yes						
53	Yes	Yes	Yes						
54	Yes								
55	Yes	Yes							
56	Yes		Yes						
57	Yes	Yes	Yes						
58	Yes								
59	Yes								
60	Yes	Yes							
61	Yes	Yes	Yes						
62	Yes								
63	Yes		Yes						
64	Yes		Yes						
65			Yes						
66	Yes	Yes	Yes						
67	Yes	Yes	Yes						
68	Yes								
69	Yes		Yes						
70	Yes								
71	Yes								
72	Yes		Yes						
73	Yes	Yes							
74	Yes								
75	Yes								
76	Yes								
77	Yes	Yes	Yes						

continued on next page...

STATE ENTITY	COLLECTS, STORES, OR MAINTAINS*			SELF-REPORTED COMPLIANCE LEVELS					
	PERSONAL INFORMATION OR HEALTH INFORMATION PROTECTED BY LAW	CONFIDENTIAL FINANCIAL DATA	OTHER SENSITIVE DATA	INFORMATION ASSET MANAGEMENT	RISK MANAGEMENT	INFORMATION SECURITY PROGRAM MANAGEMENT	INFORMATION SECURITY INCIDENT MANAGEMENT	TECHNOLOGY RECOVERY	OTHER INFORMATION SECURITY REQUIREMENTS
78	Yes	Yes	Yes	Orange	Orange	Orange	Orange	Orange	Orange
79	Yes		Yes	Orange	Orange	Orange	Orange	Orange	Orange
80	Yes			Orange	Orange	Orange	Orange	Orange	Orange
81	Yes			Orange	Orange	Orange	Orange	Orange	Orange
82	Yes		Yes	Orange	Red	Orange	Orange	Orange	Orange
83				Orange	Red	Orange	Orange	Red	Orange
84	Yes		Yes	Red	Yellow	Orange	Yellow	Orange	Yellow
85	Yes	Yes		Red	Orange	Green	Orange	Orange	Orange
86	Yes			Red	Orange	Orange	Orange	Orange	Orange
87	Yes			Red	Orange	Orange	Orange	Orange	Orange

Source: California State Auditor’s analysis of state entities’ 2017 survey responses.

\* For entries in these columns that do not contain the value “Yes,” the entity asserted in its response to our survey that it did not collect, store, or maintain this type of data.

- = **Fully compliant:** The entity asserted that it is fully compliant with all of the security standards for the control area.
- = **Mostly compliant:** The entity asserted that it has attained nearly full compliance with all of the security standards for the control area.
- = **Partially compliant:** The entity asserted that it has made measurable progress in complying, but has not addressed all of the security standards for the control area.
- = **Not compliant:** The entity asserted that it has not yet addressed the security standards for the control area.