



State High Risk

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

January 2020

REPORT 2019-601





CALIFORNIA STATE AUDITOR

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January 30, 2020
2019-601

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, my office presents this report about issues and selected state agencies that represent a high risk to the State or its residents. Our work to systematically identify and address such high-risk issues aims to enhance efficiency and effectiveness by focusing the State's resources on improving the delivery of services related to important programs or functions.

In this report, we explain why we have added the State's financial reporting and accountability to the high risk list: the State's project to modernize its financial infrastructure through implementation of the Financial Information System for California (FI\$Cal) has nearly doubled its expected costs since 2012 to more than \$1 billion, and it will not deliver key features before the project officially concludes its development stage at the end of June 2020. Further, since numerous state entities began implementing FI\$Cal, they have struggled to submit timely data for the State's annual financial statements, an issue that could ultimately negatively affect the State's credit rating.

The State continues to face seven high-risk issues that include aspects of water infrastructure, information technology oversight, and information security. We also concluded that four state agencies continue to meet our criteria for high risk: the California Department of Corrections and Rehabilitation, the California Department of Health Care Services, the California Department of Public Health, and the California State Teachers' Retirement System. Finally, we removed Covered California and the State's workforce and succession planning from our high risk list because the responsible agencies have demonstrated significant progress toward controlling risk factors.

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 such risks, we will remove the high risk designation based on our professional judgment.

Respectfully submitted,

A handwritten signature in black ink that reads "Elaine M. Howle". The signature is written in a cursive, flowing style.

ELAINE M. HOWLE, CPA
California State Auditor

Selected Abbreviations Used in This Report

CAFR	Comprehensive Annual Financial Report
CalHR	California Department of Human Resources
CalPERS	California Public Employees' Retirement System
CalSTRS	California State Teachers' Retirement System
CDCR	California Department of Corrections and Rehabilitation
CDT	California Department of Technology
CSU	California State University
LAO	Legislative Analyst's Office
LCAPs	Local Control Accountability Plans
LCFF	Local Control Funding Formula
MHSA	Mental Health Services Act
OIG	Office of the Inspector General
OPEB	Other Postemployment Benefits
PAL	Project Approval Lifecycle
PPIC	Public Policy Institute of California
UC	University of California

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INTRODUCTION

Background

State law authorizes the California State Auditor (State Auditor) to develop a state high-risk government agency audit program (high risk program). Our office uses this program to improve the operation of state government by identifying, auditing, and recommending improvements to state agencies and statewide issues at high risk for waste, fraud, abuse, or mismanagement or for having major challenges associated with their economy, efficiency, or effectiveness. In accordance with this statutory authority, the State Auditor adopted regulations in 2016 that further describe the high risk program. As we outline below, these regulations provide the criteria we used in determining the list of high-risk agencies and issues we present in this report.

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

State regulations outline the conditions under which an agency or issue is *high risk*. All four of the following conditions must be present for us to assign the high risk designation:

- 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 waste; fraud; abuse; mismanagement; or impaired economy, efficiency, or effectiveness causing such harm is so great that it constitutes a substantial risk.
- The state agencies that are suffering from or that are responsible for resolving the waste; fraud; abuse; mismanagement; or impaired economy, efficiency, or effectiveness are not taking adequate corrective actions to prevent the risk or its effects.
- An audit and the agencies' implementation of the resulting recommendations will significantly reduce or eliminate the substantial risk of serious detriment to the State or its residents.

For both state agencies and statewide issues, we consider a number of factors in determining whether there is substantial risk to the State or its residents. We consider whether the risks are already causing detriment, whether those risks are increasing, and whether changes in circumstances are likely to cause detriment. We also

assess different factors to determine whether the risks will have serious effects such as loss of life, injury, or reduction in residents' overall health or safety; impairment of the delivery of government services; significant reduction in overall effectiveness or efficiency of state government programs; and impingement of citizens' rights. Finally, we evaluate whether agencies have taken adequate measures to correct previously identified deficiencies or whether the State has taken measures to reduce the risks posed by the issues. In all cases, our professional staff make the final determination of risk level based on their independent and objective judgment.

Removal of High Risk Designation

We may remove the high risk designation under the following circumstances:

- A change in circumstances results in the risk no longer presenting the potential for serious detriment to the State or its residents.
- The responsible agencies have taken sufficient corrective action to prevent or mitigate the risk of harm.

For example, we evaluate whether the agencies have defined the root causes of the risk and identified and implemented effective measures for eliminating those causes. We also analyze whether the agencies responsible have processes for independently monitoring and measuring the effectiveness of corrective actions. When these actions result in significant progress toward resolving or mitigating the high-risk issue, we may remove the high risk designation. However, we will continue to monitor the issue. If the risk reoccurs, we will consider reinstating the high risk designation. We base the final determination of whether to remove a high risk designation on our professional judgment.

State High Risk Reports

Government Code section 8546.5 authorizes the State Auditor to audit and to publish audit reports on any state agency it identifies as high risk. In May 2007, we issued a report that provided an initial list of high-risk agencies and issues, and we have since issued several reports updating the status of those agencies and issues. We published our most recent update to the state high risk list in January 2018. Further, we have audited a selection of the high-risk agencies and issues; for instance, we published a state high risk audit report in July 2019 titled *Gaps in Oversight Contribute to Weaknesses in the State's Information Security*, Report 2018-611.

To update our analysis of high-risk agencies and issues, we interviewed knowledgeable staff at the responsible agencies to gain perspective on the extent of the risks the State faces. We also reviewed efforts that the staff at the agencies said were underway and were intended to mitigate the identified risks. In addition, we reviewed reports and other documentation relevant to the issues and consulted other state agencies when relevant.

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CHAPTER 1

New High-Risk Issue

THE TRANSITION TO FISCAL HAS DIMINISHED THE STATE'S FINANCIAL REPORTING AND ACCOUNTABILITY AND COULD LEAD TO INCREASED BORROWING COSTS

State financial reporting and accountability is now a high-risk issue because of urgent concerns regarding the State's effort to update its financial information infrastructure. The State has focused significant efforts on a project known as the Financial Information System for California (FI\$Cal), a \$1.06 billion information technology (IT) project that is currently under the eighth revision to its scope, schedule, and budget. Since numerous state entities began implementing FI\$Cal, they have struggled to submit timely data for the State's annual financial statements, an issue that could ultimately limit the State's ability to sell bonds without increased borrowing costs. Additionally, state agencies have incurred tens of millions of dollars in costs to implement FI\$Cal. Finally, the FI\$Cal project will lack key functionality when the project ends because of reductions in the project's scope over the last few years, and the current project plan update may eliminate key oversight before the FI\$Cal system is complete. For these reasons, the efficiency and effectiveness of the State's ability to report on its finances is an issue of significant risk to the State.

Background

The accuracy and timeliness of the State's financial reporting of its more than \$200 billion in annual expenditures is of vital importance to the State's residents and other stakeholders. One of the State's mechanisms for assuring fiscal oversight and transparency is based on the financial statements that state agencies produce. The State Controller's Office (State Controller) combines these statements into an annual public report known as the *Comprehensive Annual Financial Report* (CAFR). We conduct an annual audit of this report to ensure that the accounting of funds the State received and expended in the fiscal year is materially correct and that the State has complied with reporting standards and requirements. The State's CAFR represents the financial position of the State and, combined with our office's opinion on its accuracy, is an important tool for stakeholders, such as the State's creditors, to use when making decisions that affect the State's ability to borrow money affordably. In past years, the State Controller created the report

by compiling data generated by multiple financial systems among individual agencies; however, this process is changing because of the implementation of FI\$Cal.

To modernize its financial systems, the State embarked on one of its largest and most costly IT projects in its history. It intended the \$1.06 billion FI\$Cal project to unify and modernize many state agencies' financial systems. This effort was conceived in 2005 and formalized in 2007 when the State Controller, State Treasurer's Office (State Treasurer), the Department of Finance (Finance), and the Department of General Services agreed to create a statewide system for accounting, budgeting, cash management, and procurement. A committee that includes representatives from these agencies (steering committee) governs the project, with the Department of FI\$Cal (project office) providing day-to-day support for the system.

Because of the complexity of the project and the importance of its success, the State established multiple oversight mechanisms to ensure accountability. Specifically, the California Department of Technology (CDT) provides general oversight of the project, a consultant (oversight contractor) provides technical oversight, and we issue FI\$Cal monitoring reports at least annually that may include recommendations to the project office and CDT. Our monitoring reports, including Report 2017-039, January 2018; Report 2017-039.1, August 2018; Report 2018-039, January 2019; and Report 2019-039, December 2019, have identified ongoing issues with the project. For example, although the project governance initially anticipated a completion date in 2015, the current project plan states that it will end in June 2020. Further, the project's budget nearly doubled in the past eight years, from \$617 million in 2012 to \$1.06 billion in 2019, even as the steering committee removed key features from the project's scope, as we discuss below.

The State's Potential Inability to Produce Verifiable, Timely Financial Reports During the FI\$Cal Transition Could Increase the State's Borrowing Costs

Late or problematic financial statements could reduce confidence in the State's financial reporting and lead to increased borrowing costs. Ongoing challenges during the transition to FI\$Cal have caused some state entities to submit late, and in some cases estimated, financial statements to the State Controller. The State Controller found that 48 entities using FI\$Cal submitted late financial statements for fiscal year 2017–18 because of problems such as insufficient staff training and system limitations. Of those, 17 submitted estimated financial reports, a practice that increases

Ongoing challenges during the transition to FI\$Cal have caused some state entities to submit late, and in some cases estimated, financial statements to the State Controller.

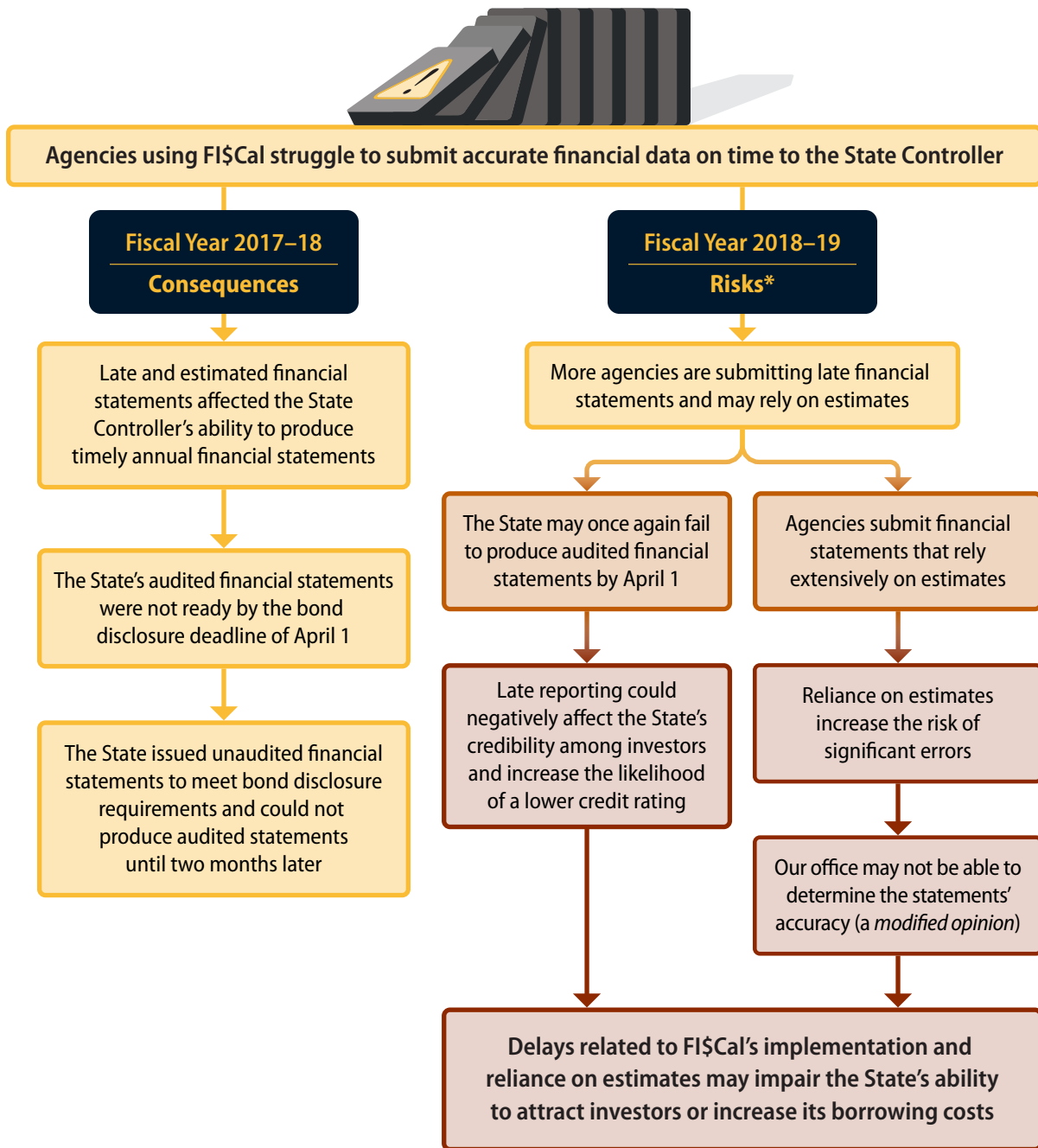
the risk of misstatements in financial statements. Though our office ultimately found that this issue did not cause any material errors in the State's annual financial statements, the State published them two months later than its spring deadline.

Moreover, many agencies may provide late reports or rely heavily on estimates for the State's upcoming CAFR for fiscal year 2018–19. Although a new Finance policy prohibits agencies from submitting estimated financial reports if not based on sound methodologies and the best available information, it remains to be seen whether agencies are able to comply with this policy because of their struggles using the FI\$Cal system. As Figure 1 demonstrates, agencies' submission of reports that do not comply with this policy or that contain estimates would hinder our ability to determine whether state financial reports are materially accurate and fairly presented. If we cannot conclude that the State's financial statements are free from material errors, the State's stakeholders will lack an important tool in evaluating the State's creditworthiness.

If decreased financial transparency and accountability related to FI\$Cal's implementation negatively affect the State's credit rating, it could potentially result in additional borrowing costs. Reliable financial reporting is an important component of the State's ability to attract and retain investors. The State's general obligation bonds, which represent the majority of its \$82 billion in outstanding debt, contain provisions that require the State to distribute to bond holders audited financial statements, if available, by April 1 of each year. This information is then made available for credit rating agencies, lenders, and potential investors to use in evaluating the State's financial health and risk. Maintaining low borrowing costs and a high credit rating depends on building and sustaining trust with financial markets. Consequently, publishing timely and audited financial statements free from material errors is important to ensuring the State's long-term access to low-interest debt funding. The State Treasurer reported in 2016 that the State saved \$180 million in borrowing costs for every \$1 billion borrowed when its credit rating improved from 2009 levels. In contrast, a downgrade in credit ratings could have the opposite effect, substantially increasing borrowing costs. Such costs could affect the State's ability to pay for critical infrastructure projects, such as schools and levees, because these projects often benefit from debt financing.

If decreased financial transparency and accountability related to FI\$Cal's implementation negatively affect the State's credit rating, it could potentially result in additional borrowing costs.

Figure 1
Late or Inaccurate Financial Statements Create the Risk of Additional Borrowing Costs



Source: Documentation and guidance from financial institutions, bond disclosure agreements, and auditing standards.

* Although the State Treasurer indicated that credit ratings did not decrease after the State issued late financial statements for fiscal year 2017-18, we remain concerned about future downgrades as agencies continue to struggle to prepare timely financial statements.

Despite the FI\$Cal Project’s Standing as One of the State’s Most Costly IT Undertakings, Its Scope No Longer Includes Key Features

The current project plan’s formal scope no longer includes the full transition to FI\$Cal of the State Controller’s process for producing state financial reports. From 2006 through 2019, the steering committee approved eight project plan updates that altered the project’s goals and timelines. As we noted in our December 2019 monitoring report, Report 2019-039, the current project plan does not include transitioning the State’s annual financial reporting exclusively to FI\$Cal before the project end date of June 2020. Figure 2 lists key features deferred past June 2020. Instead, the State Controller will continue to produce the State’s annual financial report using aging systems that will operate in parallel with the FI\$Cal system. This conflicts with the project’s purpose of modernizing the State’s financial systems. According to the State Controller and Legislative Analyst’s Office (LAO), maintaining these parallel systems is creating inefficiencies, and errors are leading to issues reconciling the two systems. The LAO said that these issues could raise questions about the validity of the data.

Figure 2
Despite Increasing Costs, the FI\$Cal Project Will Not Implement Certain Key Features Until After the Official Project End Date

Key Features Deferred Past FI\$Cal’s Official Project End Date of June 2020	
January 2018 Update	August 2019 Update
<ul style="list-style-type: none"> • Full transition to FI\$Cal for annual financial reporting • Cash management • Automated General Fund daily borrowing • Pooled money investment account allocation • General fund disbursements and receipts reporting • General fund cash forecasting 	<ul style="list-style-type: none"> • State and departmental loan accounting • Bond accounting • Year-end log inventory • Statewide year-end instructions • Statewide year-end close tool

Source: Analysis of FI\$Cal project documentation.

Despite scope reductions, the total cost of implementing FI\$Cal now far exceeds its earlier project budget; the budget grew from \$617 million in 2012 to \$1.06 billion in 2019.

Further, the most recent project plan update in August 2019 again reduced the scope of the project by deferring implementation of key features, such as departmental and statewide loan accounting functionality, to later than June 2020. These features are intended to track, manage, and record certain transactions in FI\$Cal. Because the steering committee and project office now consider implementation of these features to be a form of system maintenance outside of the project's scope, we are concerned that there is not sufficient assurance that they will complete implementation of the features or establish timelines for doing so. The issues noted above could affect the timeliness of the State's financial reporting.

Despite scope reductions, the total cost of implementing FI\$Cal now far exceeds its earlier project budget; the budget grew from \$617 million in 2012 to \$1.06 billion in 2019. In our August 2018 monitoring report, Report 2017-039.1, we identified more than \$10.5 million in contractor costs that state agencies incurred when transitioning to FI\$Cal. Since that report, we have identified nine agencies that received approval for additional staff in fiscal year 2019–20 because of their FI\$Cal transitions.¹ According to budget documentation from Finance, these agencies anticipate \$8.2 million in additional staffing and operational expenses related to FI\$Cal. Further, the LAO estimated that this total increased by \$1.5 million for other FI\$Cal-related activities and that the nine agencies anticipate spending an additional \$9.2 million on FI\$Cal staffing in fiscal year 2020–21.

These FI\$Cal-related costs are largely the result of the agencies' need for increased staff time and external contractors. For example, State Controller staff explained that under FI\$Cal, some transactions take several hours for staff to process that took less than an hour under the previous system. Similarly, Employment Development Department staff stated that every FI\$Cal function—such as transferring cash to fund daily unemployment insurance benefits—requires similar or increased staff involvement compared to the previous system. Our previous monitoring reports, Finance documentation, the LAO's estimates, and the agencies' internal estimates indicate that state agencies could accumulate more than \$42 million in additional costs because of FI\$Cal's implementation, as Figure 3 shows. These costs were or will be absorbed into the budgets of the respective agencies.

¹ We reported some of these costs in our December 2019 FI\$Cal monitoring report and conducted additional work during this high risk assessment to identify additional costs.

Figure 3
FI\$Cal Implementation May Ultimately Cost Taxpayers Over \$42 Million More Than Its Reported Project Costs



Source: Auditor-generated based on discussions with two agencies moving to FI\$Cal, contract documentation, LAO estimates, prior FI\$Cal monitoring reports, and Finance documentation.

* Includes contract costs identified during August 2018 monitoring work but not included among the examples in Report 2017-039.1.

† Includes staffing costs first reported in the December 2019 monitoring report, in addition to costs identified during this high risk assessment.

The Newest FI\$Cal Project Plan May Prematurely Eliminate Key Oversight

The current project plan may prematurely eliminate oversight by CDT before full completion of the project. As we reported in December 2019, CDT—the agency that state law charges with oversight of critical state IT projects—has not yet determined whether it will issue oversight reports on FI\$Cal after the June 2020 end date for the project. Although the 2019 updated project plan includes analysis of future costs, it does not include a budget for CDT’s oversight or for the project’s technical oversight contractor past the project end date. After we shared this concern with the project office, CDT’s director told the project office that CDT’s oversight would continue past June 2020. Further, the project office stated that it is assessing bids for a new technical oversight contract. Continuing these oversight functions will give the State important opportunities to identify problems, risks, and potential improvements in the project’s governance, schedule, budget, and system functionality.

The issues we describe in this section represent increasing impediments to the State's ability to efficiently and accurately report on its finances. Additionally, key features will not migrate to FI\$Cal until after the official end to the project, if at all, and the most recent project plan update may eliminate key oversight. We therefore expect many of the issues we have identified to persist beyond June 2020. Accordingly, state financial reporting and accountability is now a high-risk issue.

Agency Comments

The project office issued a response on behalf of both itself and the steering committee, which includes representatives from the other two responsible agencies, Finance and the State Controller. The project office provided background information on the project's recent accomplishments, noting that more than 150 departments use FI\$Cal, including the State Treasurer. Additionally, it offered detail on the status of the key features the project moved out of scope, noting that their implementation has been deferred to the maintenance and operations phase of the project—a fact we already note in our report. It also provided updates on its efforts to extend project oversight beyond June 2020. Though the project office recognized that challenges exist with implementing such a complex system, it generally disagreed with our concern that FI\$Cal's implementation may affect the State's ability to attract investors. It indicated that the State has multiple mechanisms of providing the public with information on its finances, and that late financial statements have not yet affected the State's credit rating. However, we stand by our conclusion that multiple years of late financial statements or heavy reliance on estimates may increase the likeliness of a negative effect on the State's borrowing costs in the future.

CHAPTER 2

Infrastructure and Project Management

WATER INFRASTRUCTURE REMAINS A HIGH-RISK ISSUE BECAUSE OF ONGOING EFFORTS TO IMPROVE EMERGENCY PLANNING FOR DAMS, AND BECAUSE THE STATE'S LONG-TERM WATER SUPPLY REMAINS UNCERTAIN

Aging water infrastructure within the State continues to threaten public safety. Specifically, inadequately maintained dams or those not meeting standards, especially those whose failure could affect large populations, pose significant risks to California residents. For example, the 2017 near-failure of the spillway of the largest-capacity dam under the State's direct jurisdiction, the Oroville Dam, required the evacuation of more than 180,000 people living along the Feather River. Since that time, the Department of Water Resources (Water Resources) has completed reconstruction of the Oroville Dam spillway. However, Water Resources data indicate that a majority of dams within the State with less-than-satisfactory condition ratings are in areas where they pose downstream hazard potential (hazard risk) to life or property. Further, the California Governor's Office of Emergency Services (Emergency Services) and Water Resources have not yet fully ensured the utilization of precautionary measures meant to prepare dam owners and local entities for potential dam failures. As a result of these concerns, water infrastructure remains a high-risk issue.

In addition to concerns related to dam safety, the State's ability to maintain reliable access to water remains a critical component of the overall risks to its water infrastructure. California has attempted to address water infrastructure and supply problems for more than a decade. However, recent developments have significantly altered its proposed solution. In 2019 the California State WaterFix Project (WaterFix)—the State's dual-tunnel project to improve water availability—transitioned to a one-tunnel solution, referred to as the Delta Conveyance project. Because this project is still in its initial stages, we will continue to monitor its implementation.

Background

State law vests Water Resources with authority over dams within the State's jurisdiction, which it oversees through its Division of Safety of Dams (Dam Safety Division). The Dam Safety Division inspects more than 1,200 dams throughout the State that Water Resources monitors, assigning them condition ratings and

Water Resources' Dam Condition Ratings

- **Satisfactory:** No existing or potential dam safety deficiencies and acceptable performance is expected under all conditions.
- **Fair:** No existing dam safety deficiencies for normal conditions. However, extreme hydrologic and/or seismic events may result in a safety deficiency and further action may be necessary, or dam is not certified and its safety is under evaluation.
- **Poor:** Existing dam safety deficiency for conditions that may realistically occur and remedial action is necessary.
- **Unsatisfactory:** Existing safety deficiency that requires immediate or emergency remedial action.

Water Resources' Hazard Risk Classifications*

- **Low:** No probable loss of human life and low economic and environmental losses generally limited to the owner's property.
- **Significant:** No probable loss of human life but can cause economic loss, environmental damage, impacts to critical facilities, or other significant effects.
- **High:** Expected to cause loss of at least one human life.
- **Extremely High:** Expected to cause considerable loss of human life or result in inundation of an area with a population of 1,000 or more people or of critical infrastructure.

Source: Water Resources' Dam Safety Division.

* The hazard risk indicates potential impacts to life and property downstream of a dam should it fail when operating with a full reservoir.

identifying the hazard risk for each, as the text box illustrates. A dam's hazard risk classification indicates the potential consequence of a failure. For example, Lower Blue Lake Dam in Alpine County is rated in fair condition with a significant hazard risk. Following events at the Oroville Dam in 2017, the Legislature amended state law to require that regulated owners of dams with certain hazard risk classifications develop emergency action plans (emergency plan) to address potential flood emergencies.² State law requires that emergency plans include inundation maps—that Water Resources must review and approve—detailing potential flooding under different scenarios. Once Water Resources has approved the inundation maps, dam owners must submit an emergency plan to Emergency Services for review and approval. Emergency plans specify actions to minimize loss of life and property damage in various emergency conditions.

In addition, significant cost increases and delays in the WaterFix project contributed to our designation of water infrastructure as a high-risk issue. Although the State has developed extensive infrastructure to ensure that its residents have access to ready supplies of water, an integral component of the system is a network of engineered channels and agricultural lowlands at the confluence of the Sacramento and San Joaquin rivers. This network is called the Delta. The State Water Project supplies water through the Delta to

more than 27 million people and to farmland for irrigation. Water Resources and its partner agencies intended for WaterFix to address concerns about the negative impacts—particularly on endangered species—of exporting water through pumps in the Delta for use by local water agencies. These concerns prompted regulators to reduce the availability of water exports from the Delta, which detrimentally affected certain communities and farms. WaterFix proposed to create new facilities to transfer water from the Sacramento River through two tunnels to improve water supply reliability and quality, as well as conserve wildlife in the Delta. However, WaterFix faced significant cost increases and legal challenges. In 2019 the Governor directed state agencies to study an alternative solution. As a result, the State transitioned to a new single-tunnel project.

² Regulated owners can include state agencies, local governments, and private owners.

Aging Water Infrastructure in the State Continues to Pose a Significant Risk to California Residents

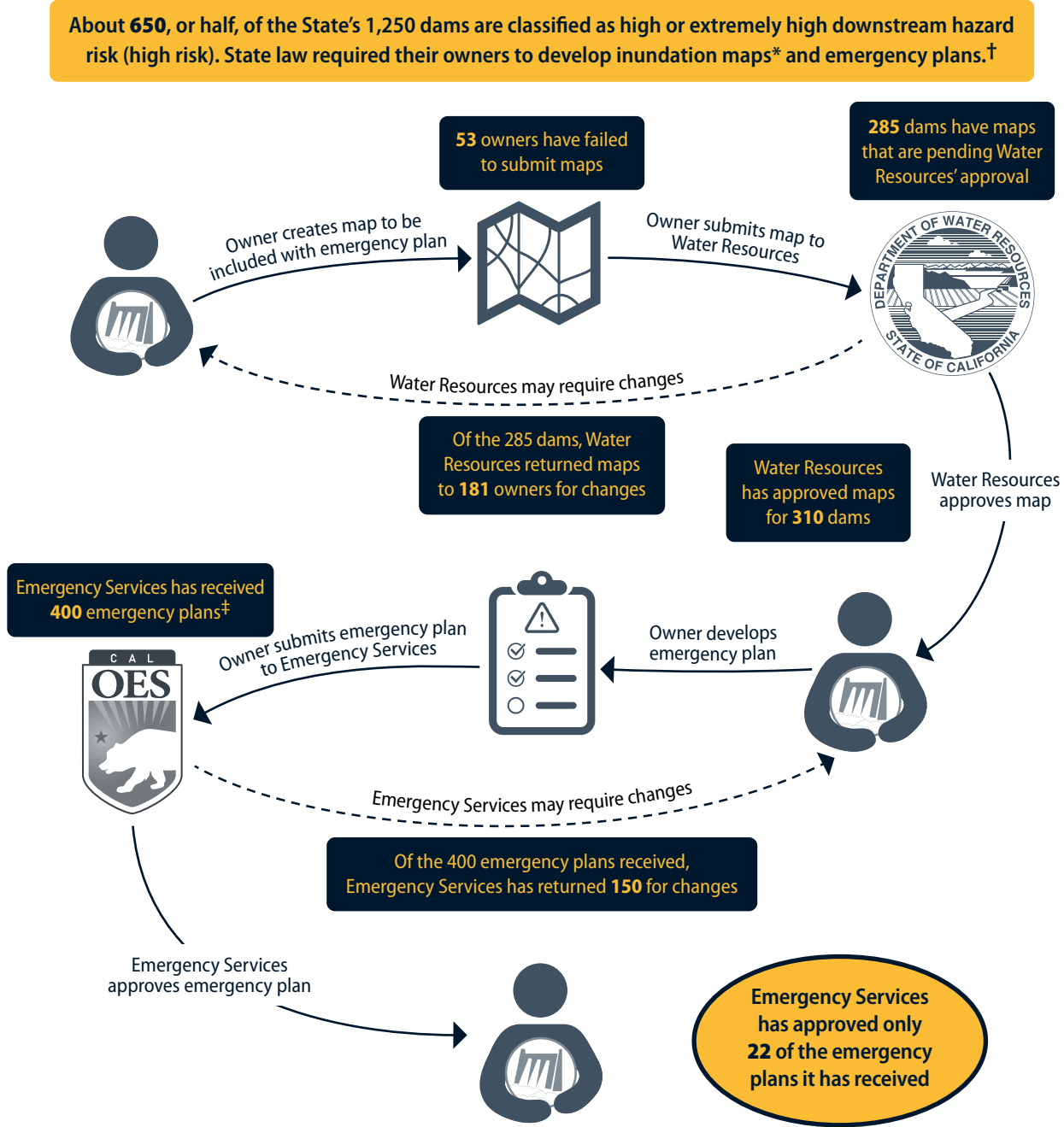
The condition of some of the State's most potentially hazardous dams remains an issue of concern for the State. We noted concerns in our 2018 high-risk report regarding the age and condition of dams within the State. As of October 2019, Water Resources data indicate that 102 dams in the State had less-than-satisfactory condition ratings of *fair*, *poor*, or *unsatisfactory*. Of those, 84 had hazard classifications of *significant* or above, indicating risk to life or property should the dams fail. State law requires dam owners to correct deficiencies that Water Resources identifies constituting a danger to life or property, yet funding such repairs is challenging. According to Water Resources, there are no state-level programs that provide financial assistance to dam owners for repairing their dams and resolving deficiencies. Until an avenue of funding becomes available to facilitate repairs and improvements to high-risk dams, the water infrastructure in the State will continue to pose a significant risk.

Further, Emergency Services and Water Resources have been slow to ensure the completion of emergency action planning meant to prepare dam owners and local entities for potential dam failures. As we explain previously, state law required owners of certain dams to submit emergency plans, which must include approved inundation maps, to Emergency Services. The law required owners of dams classified as *extremely high hazard risk* to submit emergency plans by January 1, 2018, and owners of dams classified as *high hazard risk* to submit their emergency plans by January 1, 2019. Water Resources is responsible for approving inundation maps, while Emergency Services approves the emergency plans. As Figure 4 shows, of the State's nearly 650 dams classified as *high hazard risk* or *extremely high hazard risk*, Water Resources was in the process of reviewing maps for 285 dams, and had approved maps for 310 dams, as of November 2019. Of greater concern, Emergency Services had approved only 22 of the about 400 emergency plans it had received from dam owners as of November 2019. Emergency Services indicated that this delay is primarily because it has had to return plans to dam owners for revision. Nearly 150 of the plans it had returned remain outstanding.

State law does not require dam owners to resubmit plans within a defined period, and Emergency Services has stated it does not favor specifying a deadline because additional time is sometimes necessary to educate and conduct outreach to dam owners. This stance is concerning given that Emergency Services has currently approved only 5 percent of the approximately 400 plans it has received. Further, state law requires dam owners to submit plans for dams classified as *significant hazard risk* to Emergency Services before

Water Resources data indicate that 102 dams in the State had less-than-satisfactory condition ratings, and, of those, 84 had hazard classifications indicating risk to life or property should the dams fail.

Figure 4
The Vast Majority of High-Risk Dams Still Do Not Have Approved Emergency Plans



Source: State law and interviews with Water Resources' and Emergency Services' staff.

Notes: The numbers we present in this figure are based on data provided by Water Resources' and Emergency Services' staff. Because of differences in how each agency characterizes the status of maps and plans, we have slightly adjusted a few of the numbers to account for the various actions depicted in the figure that are performed by the owners and the two agencies and to reconcile the quantities of such activities.

Data is current as of November 2019.

* *Inundation maps* identify critical infrastructure and areas in which populations require protective measures, warnings, or evacuation planning. State law requires Water Resources to process and approve maps submitted by dam owners.

† *Emergency plans* identify potential emergency conditions and specify actions to minimize loss of life and property damage. Emergency Services reviews and approves emergency plans submitted by dam owners, which must include inundation maps.

‡ Total includes 154 emergency plans pending inundation maps.

January 2, 2021. This requirement will result in 250 additional plans Emergency Services will need to approve in addition to the plans currently outstanding. Emergency Services acknowledges that this group of dam owners may require even more attention and guidance. Unless Water Resources and Emergency Services take sufficient action to ensure that dam owners complete adequate emergency planning, the State will continue to have little assurance that its emergency responses to potential dam failures will be sufficient.

Existing efforts by Emergency Services and Water Resources are not sufficient to address the lack of approved plans. For example, despite spending an average of 500 days to process the 22 emergency plans it has approved to date, Emergency Services has not yet determined the number of staff it needs to process and approve the remaining plans. In the meantime, Emergency Services has sent letters to *high-* and *extremely high-hazard risk* dam owners that have not submitted emergency plans, directing them to do so. It also plans to provide education and outreach to dam owners to increase the quality of their submissions. However, although Emergency Services has indicated that dam owners who have submitted emergency plans are sometimes slow to respond to requests for revisions, it has not asked Water Resources, the agency with enforcement power, to take enforcement actions such as levying fines. Moreover, Water Resources has not yet approved inundation maps for 285 of nearly 600 dams, has returned maps to 181 owners for changes, and has not received significantly overdue submissions from 53 dam owners. Water Resources indicated that when it is aware of a safety issue, it has imposed restrictions on reservoirs to mitigate the risk. Nevertheless, the potentially catastrophic consequences of a dam failure, the significant number of dams in less than satisfactory condition, and the remaining work necessary to ensure that emergency planning is complete and approved lead us to conclude that water infrastructure remains a high-risk issue.

Further, the effect on the State's water supply of the State's proposed new single-tunnel replacement to WaterFix remains unknown. Implementation of a plan to transfer water from the Sacramento River to California residents may benefit from work the State has completed in the 13 years since it first attempted to address water infrastructure and supply problems in the Delta through the Delta Habitat Conservation and Conveyance Program (conservation program), an effort that eventually became WaterFix. The conservation program evaluated multiple conservation and conveyance alternatives before selecting WaterFix. Water Resources has stated that the environmental review process for the new single-tunnel project may make use of such past studies and analyses. In addition to utilizing existing resources when available,

Unless Water Resources and Emergency Services take sufficient action to ensure that dam owners complete adequate emergency planning, the State will continue to have little assurance that its emergency responses to potential dam failures will be sufficient.

Water Resources is currently developing a schedule for the various phases of the environmental review process, required documents, and opportunities for public comment necessary to implement the new plan. We will continue to monitor the eventual effect of a one-tunnel project on the State's water infrastructure.

Agency Comments

Natural Resources and Water Resources issued a joint response, in which they agreed that dam safety and water reliability are profoundly important to the State. They indicated that Water Resources is updating its dam safety inspection protocols and dedicating additional staff to its dam safety program. Additionally, they stated that Water Resources has taken an aggressive approach to evaluating dams for seismic risk and is approving inundation maps. They noted that Water Resources has the authority to impose restrictions on dam owners to mitigate safety risks until issues are remediated and that the approval of inundation maps involves significant engagement with dam owners. Further, they stated that Water Resources has imposed restrictions on reservoir levels on 41 dams under its jurisdiction. Finally, they noted that Water Resources is making progress on the single-tunnel Delta conveyance project. We appreciate that Water Resources is making progress in addressing dam safety and water infrastructure. Nevertheless, for the reasons we note, this remains a high-risk issue. Water Resources also offered a number of textual edits. We reviewed the suggestions and incorporated them when, in our professional judgment, they provided necessary corrections, context, or clarification.

Emergency Services did not indicate whether it agreed or disagreed with our conclusion that water infrastructure is a high-risk issue. Instead Emergency Services noted that it believed we minimized the work that it has accomplished implementing legislation related to dam safety. Emergency Services further stated that extensive interactive planning work has been underway to ensure that dam owners submit quality emergency plans. It also emphasized that dam owners are responsible for most of the delay in finalizing emergency plans. We do not dispute that Emergency Services has made progress in addressing the issues surrounding dam safety; nevertheless, the large number of outstanding emergency plans leads us to retain the issue of water infrastructure on our high-risk list. Emergency Services also raised concerns about how we characterized some of its activities in the report. We reviewed Emergency Services' concerns and addressed them through edits when, in our professional judgment, they improved the accuracy or clarity of our text.

THE TRANSPORTATION COMMISSION AND CALTRANS HAVE MADE PROGRESS IMPROVING THE STATE'S TRANSPORTATION INFRASTRUCTURE, BUT HIGH RISK MONITORING SHOULD CONTINUE

Although the California Department of Transportation (Caltrans) and the California Transportation Commission (Transportation Commission) have demonstrated a commitment to repairing the State's aging transportation infrastructure system, this issue will remain high-risk as repair efforts continue. The Transportation Commission adopted more ambitious annual benchmarks than the performance goals the Legislature established when it passed the Road Repair and Accountability Act (Repair Act) and laid the groundwork necessary to ensure oversight of Repair Act funds. In accordance with its oversight role and the benchmarks it created, the Transportation Commission found in December 2018 that Caltrans had made initial progress in reducing the number of deferred maintenance projects necessary to improve the State's transportation infrastructure. However, Caltrans' implementation of new mandatory federal reporting requirements and internal process improvements has increased the complexity of tracking its progress in achieving Repair Act objectives. These factors and the lengthy implementation period of transportation projects indicate that the State will not experience the full benefits resulting from Repair Act funds for several years.

Background

Caltrans and the Transportation Commission are responsible for ensuring that the State's transportation infrastructure is in good condition. Caltrans plans, develops, maintains, and operates the legislatively designated California State Highway System (state system). The state system includes 49,600 lane miles of pavement, 13,200 bridges, 205,000 culverts and drainage facilities, and nearly 19,000 transportation management system assets. In terms of their cost and coverage, pavement and bridges are the most significant assets of the state system. The Transportation Commission programs and allocates funds for the construction of highway, transit, and active transportation improvements throughout California. It also advises and assists the California State Transportation Agency (Transportation Agency) and the Legislature in formulating and evaluating state policies and plans for California's transportation programs. Further, the Transportation Commission assesses Caltrans' effectiveness in reducing deferred maintenance and improving road conditions in the state system.

We initially designated deteriorating transportation infrastructure as a high-risk issue in our first high risk report in 2007. Much of the State's infrastructure was constructed in the 1950s and 1960s. However, inadequate funding resulted in a large backlog of maintenance projects. According to the Legislature, before the adoption of the Repair Act in April 2017, California had not increased statewide taxes or fees dedicated to the maintenance of its transportation infrastructure for more than two decades. In February 2019, the LAO reported on \$50 billion in deferred maintenance of the state system.

Caltrans' Performance Goals, According to the Repair Act

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, chips, and cracks.
3. At least 90 percent of culverts are in good or fair condition.*
4. At least 90 percent of the transportation management system is in good or fair condition.†
5. At least an additional 500 bridges are fixed.

Source: Repair Act and Caltrans documents.

* Culverts are tunnels or drains carrying a stream or open drain under a road.

† The transportation management system includes elements such as cameras, ramp meters, detection systems, and message signs that perform critical functions to keep people, vehicles, and goods moving.

To improve California's transportation system, the Legislature passed the Repair Act to provide increased revenue from a tax on fuel and a fee on vehicle registration. Caltrans indicated that the State will invest \$54 billion for state and local transportation infrastructure, including public transit, over a 10-year period. The Repair Act set five performance goals, as the text box notes, for Caltrans to achieve by the end of 2027. As an additional accountability measure, the Repair Act established the Independent Office of Audits and Investigations within Caltrans and directed the Governor to appoint an inspector general, subject to Senate confirmation, to head the office. State law tasks the inspector general with ensuring that Caltrans administers programs effectively, efficiently, and economically.

Additional Monitoring Is Necessary to Determine Whether Caltrans Will Make Sufficient Progress in Addressing the Deferred Maintenance of the State System

Because of project delivery time frames, it will be several years before Caltrans can demonstrate its overall effectiveness in using the Repair Act's additional funding to significantly improve the state system. The Repair Act sets several performance goals and requires Caltrans to report to the Transportation Commission annually; however, Caltrans has not reported progress on the goal associated with pothole repairs because it is changing the way it measures those outcomes. Staff indicated that measuring repair progress on potholes is particularly difficult and that Caltrans is refining its methodology to ensure accurate measurements. In addition, Caltrans is in the process of developing an inventory of culverts and does not anticipate completing condition assessments of its culverts until 2023. Further, according to Caltrans' state asset management engineer, pavement rehabilitation projects take between two and

five years on average to complete. The Legislature expects that the Repair Act’s additional funding will bring the system into a state of good repair by 2027. Demonstrable outcomes will require several years to achieve, thus, it is too soon to assess whether Caltrans will meet the Legislature’s expectations.

Further, recent changes in federal law established nationwide pavement assessment criteria that make analysis of Caltrans’ progress challenging. New federal requirements for assessing road conditions, which Caltrans must follow, produce vastly different results than the methodology Caltrans previously used. For example, Caltrans concluded that in 2016 nearly 18 percent of the state system was in poor condition. However, when Caltrans applied the new federal requirements to the same highway data, it concluded that only 6 percent was in poor condition. This significant change in requirements limits our ability to assess Caltrans’ progress on improving road conditions until it is able to report more comparable data over time. We will continue to monitor Caltrans’ progress as it accumulates more data using the new requirements.

Although progress toward the goals remains unclear, the Transportation Commission and Caltrans have demonstrated a commitment to improving the transportation system. As state law authorizes, Caltrans and the Transportation Commission established annual benchmarks for the condition of some assets that are more rigorous than the goals in the Repair Act. For example, the Repair Act states that 98 percent of state highway pavement should be in good or fair condition by the end of 2027. However, the Transportation Commission adopted more specific benchmarks that individually detail the required percentage of good and fair lane miles. If Caltrans meets these benchmarks, California will have 98.5 percent of state highway pavement in good or fair condition—with more than half of all roads in good condition—in 2027.

Further, the Transportation Commission’s efforts to oversee the use of Repair Act funds provide increased accountability. The text box lists the seven programs receiving Repair Act funds that the Transportation Commission directly oversees. In addition, state law requires the Transportation Commission to evaluate Caltrans’ progress toward Repair Act goals on an annual basis. In order to accomplish this requirement, the Transportation Commission developed guidelines

The Transportation Commission Oversees Programs That Receive Repair Act Funds

1. **State Highway Operation and Protection Program**—Funds projects related to the maintenance, safety, operation, and rehabilitation of the state system that do not add new capacity to the system.
2. **Active Transportation Program**—Funds projects that encourage biking and walking and that improve safety.
3. **Solutions for Congested Corridors Program**—Funds projects designed to reduce congestion in highly congested corridors.
4. **Local Streets and Roads**—Funds road maintenance, rehabilitation, and critical safety projects on local streets.
5. **Trade Corridor Enhancement Program**—Funds improvements on corridors that have a high volume of freight movement.
6. **Local Partnership Program**—Provides funding to counties, cities, districts, and regional transportation agencies for transportation improvements.
7. **State Transportation Improvement Program**—Funds a five-year plan for state highway improvements, intercity rail, and regional highway and transit improvements.

Source: The Transportation Commission’s report on Repair Act implementation.

for the State Highway Operation and Protection Program that require Caltrans to submit quarterly reports on its progress. The Transportation Commission conducted its first annual evaluation in November 2018 and found that Caltrans made progress in reducing deferred maintenance and meeting performance goals, as Table 1 shows. This evaluation demonstrates that the Transportation Commission is actively monitoring Caltrans' progress.

Table 1
Caltrans Expects to Meet Repair Act Goals

ASSET	REPAIR ACT GOAL	CALTRANS INTERNAL 2027 TARGET	CURRENT CONDITION
Pavement	98% in good or fair condition	98.5% in good or fair condition	98.9% in good or fair condition*
Bridges	500 additional fixed	1,060 additional fixed†	259 additional fixed†
Culverts	90% in good or fair condition	90% in good or fair condition	90% in good or fair condition*
Transportation Management System	90% in good or fair condition	90% in good or fair condition	67% in good or fair condition

Source: Caltrans reports and state law.

* Because of physical deterioration of assets over time, Caltrans must maintain current conditions to meet Repair Act targets.

† Numbers are based on best available information. Caltrans and the Transportation Commission are updating the methodology they use to assess progress in this area. As a result, these numbers are subject to change.

Finally, Caltrans' recently created Office of the Inspector General (Caltrans' Inspector General) completed six audits related to Caltrans' implementation of Repair Act requirements and identified several changes necessary to help Caltrans achieve Repair Act goals. For example, the Caltrans' Inspector General's findings led Caltrans to expedite its inspections of culverts by four years, from an original 2027 completion date to an approximate 2023 completion date. The additional oversight from Caltrans' Inspector General and from the Transportation Commission, as well as Caltrans' demonstrated commitment to improvement, represent progress towards implementing the Repair Act. Nevertheless, these changes are recent; until Caltrans and the Transportation Commission can demonstrate sustained progress toward ensuring the State's roads are in good repair, transportation infrastructure will remain a high-risk issue.

Agency Comments

The Transportation Agency, which responded on behalf of Caltrans and the Transportation Commission, concurred with our conclusion that it is too early to fully assess the State's efforts to ensure the efficient and effective use of Repair Act funds.

ALTHOUGH CDT HAS AN UPDATED PROJECT APPROVAL PROCESS, WE REMAIN CONCERNED ABOUT THE IMPLEMENTATION OF THE STATE'S INFORMATION SYSTEMS AND THE CONTINUED RELIANCE ON LEGACY SYSTEMS

In our 2018 high risk assessment, we reported that CDT successfully implemented a project approval process. However, state agencies have thus far completed relatively few projects that CDT approved through that process. Given the significant cost increases and delays that state IT projects approved before 2016 have experienced, this relatively new process must demonstrate consistent success across projects of varied importance to address our concerns with new IT projects and the replacement of legacy systems. Thus, IT oversight remains a high-risk issue.

Background

CDT is responsible for approving, overseeing, and monitoring state IT projects, as well as completing regular project oversight reports detailing projects' progress against their objectives, scope, schedule, and cost. These reports identify and quantify any issues and risks affecting the project's objectives and include any recommendations that result from the reviews. If a project is in danger of not meeting its objectives, CDT may require the project team to develop a corrective action plan (action plan). If the project team does not effectively implement the action plan, CDT may take further action, including suspending or terminating the project. However, CDT staff stated that they work with project teams on an ongoing basis to provide guidance and information regarding risks and issues so the teams can address them, thereby avoiding more serious actions.

We designated the State's oversight of IT projects as high risk in our initial 2007 high risk list. We continued to assess the State's oversight of IT projects as high risk in 2013 because of the high costs of certain projects and the failure of others. Our January 2018 assessment found that CDT had implemented a new process—the Project Approval Lifecycle (PAL)—in 2016 that it intended to address risks of project failure. PAL divides CDT's approval process into four stages and requires that state agencies implementing IT projects conduct specific planning-related analyses and submit associated planning documents to CDT. Agencies must also obtain CDT's approval for each of the four stages before they can begin their IT projects. Currently, CDT requires the use of PAL for all new state IT projects. However, we noted in our January 2018 report that no state agency at that time had fully implemented a project using the new process. In addition, we were concerned that some state agencies continued to rely on legacy IT systems—outdated and inefficient systems that present compatibility issues or lack functionality.

IT Projects That CDT Approved Before PAL Have Experienced Problems, While PAL's Effectiveness Remains Unclear

Projects that CDT approved before implementing PAL have experienced significant delays and cost increases. As of August 2019, CDT reported that 10 IT projects it approved before PAL were under development, with an aggregate cost of almost \$1.9 billion. CDT classified all of these projects as medium or high criticality.³ CDT indicated that four of the 10 projects have required action plans and that two others have existing risks that may require future corrective actions. CDT stated that an IT project's rating is likely to fluctuate throughout its implementation, and that a high risk rating does not mean a project is failing. Nevertheless, some of these projects have experienced significant delays and cost increases. For instance, FI\$Cal began in 2005 and has required many changes that extended its schedule, increased its estimated cost, and removed some functionality, as we discussed previously. On a smaller scale, the California Department of Social Services (Social Services) anticipated it would implement its Child Welfare Services New System project by September 2017, with an estimated cost of \$393 million. However, Social Services currently expects to complete the project in June 2020 at an estimated cost of \$421 million. CDT staff stated that they are assisting the Social Services project team as it formulates strategies to accelerate delivery of the project and to ensure that it meets its goals. However, a May 2019 CDT report indicated that the project continues to struggle with functionality in certain areas and may require additional modifications.

Although PAL may improve IT project planning, CDT has yet to sufficiently demonstrate its effectiveness on high criticality projects.

Although PAL may improve IT project planning, CDT has yet to sufficiently demonstrate its effectiveness on high criticality projects. As of August 2019, CDT was overseeing 10 projects approved through PAL with an aggregate cost of \$630 million. CDT classified six of these projects as medium or high criticality and four as low criticality. However, because CDT implemented PAL relatively recently, only a few medium criticality projects approved through it have been completed. When we asked CDT to assess PAL's success in improving project time frames and management, it indicated its belief that PAL has worked well so far and noted that only two PAL-approved projects required project modifications, both after legislation modified their scopes. However, CDT stated that it is still collecting data on projects it has approved through PAL and acknowledged that limited data exists for measuring PAL's success.

³ Projects can have ratings of low, medium, or high criticality as a measure of their risk and sensitivity. These ratings are based on the projects' business and technical attributes, including cost and resource need.

Improvements in the State's processes to manage and complete IT projects may help address a further area of concern—some state agencies' continued reliance on legacy IT systems that are based on outdated technology that may present compatibility issues or lack functionality. For example, the State Controller—responsible for issuing pay to the State's workforce—continues to rely on a payroll system dating back to the 1970s. Although the State Controller is using PAL to plan for a new payroll system, CDT had approved only the first step of the process as of July 2019. When the State fully implements additional projects approved through PAL, including high criticality projects, the State will be better able to assess whether PAL is resulting in better IT project outcomes.

Agency Comments

CDT reiterated its belief that the PAL process has worked well on medium and low criticality projects. Nonetheless, it noted high criticality projects take longer to plan and implement, which aligns with our conclusion that more time is needed to demonstrate PAL's effectiveness.

INFORMATION SECURITY REMAINS A HIGH-RISK ISSUE BECAUSE OF CONTINUED DEFICIENCIES IN INFORMATION SYSTEM CONTROLS

More than six years have passed since we initially designated information security as a high-risk issue to the State, and weaknesses continue to persist across all types of state entities. Although CDT fully implemented our recommendations for helping the entities it oversees improve their information security, it is too early for us to evaluate the effectiveness of its efforts. Moreover, state entities that do not fall under the purview of CDT need to do more to safeguard the information they collect, maintain, and store. Because of the continued deficiencies in the security controls that state entities have implemented over their information systems, information security remains a high-risk issue to the State.

Background

The State's information assets, including its data processing capabilities, IT infrastructure, and data, are an essential public resource. In fact, for many state entities, program operations would essentially cease in the absence of key computer systems, and in some cases the failure or disruption of a system would immediately

Implementing appropriate security measures and controls is critical to ensuring the confidentiality, integrity, and availability of both the information and the information systems that state entities need to accomplish their missions, fulfill their legal responsibilities, and maintain their day-to-day operations.

jeopardize public health and safety. These consequences highlight the importance of information security. *Information security* refers to protecting information, information systems, equipment, software, and people from a wide spectrum of threats and risks. Implementing appropriate security measures and controls is critical to ensuring the confidentiality, integrity, and availability of both the information and the information systems that state entities need to accomplish their missions, fulfill their legal responsibilities, and maintain their day-to-day operations. Information security is also the means by which state entities can protect the privacy of the personal information they hold, such as their employees' Social Security numbers and home addresses.

CDT is responsible for providing direction for the State's information security. State law generally requires state entities within the executive branch that are under the Governor's direct authority (reporting entities) to comply with the information security practices that CDT prescribes and to annually report to CDT on their compliance with these practices. However, state law does not apply CDT policies and procedures to entities that fall outside of the Governor's direct authority (nonreporting entities), such as constitutional offices and those in the judicial branch.

We first identified information security as a high-risk issue in 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, when we concluded that CDT was performing limited reviews to assess the security controls that the state entities it oversees had implemented for their information systems. We also discussed the deficiencies we noted in such controls at two entities we audited. 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, we noted that many reporting entities have poor controls over their information systems, placing some of the State's most sensitive information at risk. Accordingly, we made nine recommendations to CDT 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. In our January 2018 report, we reported that although CDT had made progress toward improving its oversight, reporting entities still had significant room for improvement and their lack of compliance with the security standards remained a significant risk to the State. We also noted that the information security practices of nonreporting entities might warrant further review in the future.

Although CDT Has Made Improvements to Its Oversight of Reporting Entities, It Is Too Early to Evaluate the Effectiveness of Its Efforts

By October 2018, CDT had fully implemented the nine recommendations we made in our August 2015 report. However, not enough time has passed to measure whether reporting entities have subsequently improved the security of their information. For example, CDT implemented the risk reporting module of its California Compliance and Security Incident Reporting System (Cal-CSIRS), which features a self-assessment tool that reporting entities must use as of January 2018 to determine their level of compliance with the security standards. The self-assessment process culminates with the directors of the reporting entities certifying to CDT that they have directed the completion of the required information security and privacy program compliance reporting and associated risk response activities. Each reporting entity's annual certification must include a report of the high risk findings it identified through the self-assessment and its plan for addressing them.

To validate reporting entities' self-assessments, CDT began a new risk-based, four-year audit lifecycle in fiscal year 2018–19. During this lifecycle, CDT plans to apply a consistent methodology to evaluate the information security status of selected reporting entities by conducting an audit, a follow-up audit, and two independent security assessments in nonconsecutive years. According to CDT, the first audit lifecycle will establish an initial information security baseline status for each reporting entity and will serve as a benchmark upon which to gauge that reporting entity's progress moving forward. In addition, CDT asserted that it is developing a new automated tool to combine data from different sources, such as Cal-CSIRS and the audit lifecycle, to better identify statewide trends in information security. It is premature for us to assess the effectiveness of CDT's efforts because it has not yet fully assessed the current information security status of reporting entities. Nonetheless, CDT's initial efforts have identified information security deficiencies across multiple reporting entities.

CDT's initial improvements to its oversight efforts have identified information security deficiencies across multiple reporting entities.

Gaps in Oversight Have Contributed to Weaknesses in Nonreporting Entities' Information Security

In addition to the weaknesses we identified for reporting entities, we also found that nonreporting entities need to do more to safeguard the information they collect, maintain, and store. As we state in our July 2019 report about weaknesses in the State's information security, we surveyed 33 nonreporting entities and reviewed 10 of them in detail. Twenty-nine of the 33 had obtained information security assessments to evaluate their compliance

with the specific security standards they selected. During these assessments, 24 of the 33 entities learned that they were only partially compliant with standards, and 21 of the 33 identified high risk deficiencies. Moreover, nonreporting entities may be unaware of their other information security weaknesses because many of them have relied on assessments that were limited in scope. For example, five of the 10 nonreporting entities we reviewed had assessed compliance with only a portion of their selected standards, and one had neither adopted any standards nor performed any assessments.

Although nonreporting entities are not subject to CDT's policies and procedures, some are subject to an oversight framework that requires them to assess their information security regularly. This was the case for three of the four nonreporting entities that had fully assessed their selected standards, leading us to conclude that external oversight improves a state entity's information security status. Accordingly, we recommended that the Legislature amend state law to require all nonreporting entities to obtain or perform comprehensive information security assessments at least every three years and to confidentially submit certifications of their compliance to the Legislature.

Agency Comments

CDT generally agreed with our conclusion that information security is an issue of concern to the State. It also noted that its efforts to audit and assess state entities have yielded early indications that entities under its oversight are implementing recommendations, remediating deficiencies, and becoming more resilient against cyber threats.

CHAPTER 3

Public Education

THE STATE HAS NOT ENSURED THAT LOCAL EDUCATIONAL AGENCIES SPEND LCFF FUNDS APPROPRIATELY

We initially designated K–12 education as a high-risk issue in part because of possible challenges we believed could arise from the introduction of the Local Control Funding Formula (LCFF). LCFF requires local educational agencies to use certain additional funds they receive through the formula proportionally to support vulnerable classifications of students. Although state law identifies the student populations for whom the Legislature has designated these LCFF funds, the State’s approach has not ensured that this funding is benefitting the students for whom it was intended. In addition, the State Board of Education (State Board) and the California Department of Education (Education) have not implemented sufficient tools that track funding and outcomes. Such tools would allow stakeholders to hold local educational agencies accountable for continuing to fund effective services and for discontinuing ineffective services.

Background

California’s public education system serves more than 6.2 million children and involves both statewide and local entities. The State Board is the State’s K–12 policymaking body and adopts academic standards, assessments, and templates for Local Control Accountability Plans (LCAPs). State law created LCAPs to ensure that school districts address state educational priorities while engaging with local stakeholders. Education’s role is to provide oversight to the State’s public school system and enforce education law and regulations. The State’s 58 county offices of education are responsible for approving school district budgets and verifying that their LCAPs adhere to the State Board’s templates, among other duties.

The Legislature established LCFF in 2013 to address achievement gaps of particular student groups—including English learners, youth in foster care, and students from low-income households—whom LCFF calls *unduplicated pupils* and whom we refer to as *intended students*. Under LCFF, the State gives each local educational agency a grade-specific base grant calculated using its average daily student attendance, along with supplemental and concentration funding (additional funding) based on the proportions of intended students

it serves. However, local educational agencies must use additional funding to increase or improve services for intended students in proportion to the amount of additional funds they receive. In order to assist local educational agencies in evaluating their strengths and weaknesses utilizing performance metrics, state law required Education to create and maintain a dashboard of performance metrics, which it implemented in 2017.

We designated K–12 education as high risk in 2013 because of concerns related to the availability of funds to support LCFF and related to the implementation of new Common Core standards. In our 2018 update, we found that the State had significantly narrowed the LCFF funding gap and increased its investment in Common Core implementation. However, in our prior high risk review, we noted that the lack of state oversight of LCFF spending persisted.

The State Should Modify Requirements to Ensure That Local Educational Agencies Use LCFF Funds Appropriately

In March 2019, the Joint Legislative Audit Committee directed the California State Auditor to conduct an audit to assess LCAPs and determine whether school districts were appropriately distributing and spending LCFF funds. Our November 2019 report titled *K–12 Local Control Funding: The State’s Approach Has Not Ensured That Significant Funding Is Benefitting Students as Intended to Close Achievement Gaps*, Report 2019-101, found that the State has not required that school districts sufficiently track how they spend their additional funding and that the LCAPs do not always include clear information regarding how the districts’ spending will benefit intended students. For example, although the Legislature tasked the State Board with drafting regulations for the expenditure of LCFF funds, the current requirements that districts must meet when spending additional funding are essentially meaningless because it is unclear how they could demonstrate that they increased or improved services in proportion to the amount of additional funding they received. Further, neither county offices of education nor Education is responsible for verifying whether districts met the required proportional increases. Moreover, districts do not always spend all their additional funding during the year and often do not analyze the effectiveness of the individual programs they do fund.

Weaknesses in the LCAP template and the limited reviews that state law requires county offices of education to perform have contributed to the LCAPs’ lack of transparency.

Weaknesses in the LCAP template and the limited reviews that state law requires county offices of education to perform have contributed to the LCAPs’ lack of transparency. Our audit reviewed three school districts and found that their LCAPs showed they intended to use significant amounts of their additional funding to pay for services that appear to be part of their overall educational programs, such as professional development. However, their

LCAPs did not explain how these services would be principally directed towards intended students, as state law requires. The audit recommended that the Legislature amend existing law to require that districts identify any unspent funds and retain their designation as funds for intended students. Further, it recommended that the State Board revise the LCAP template to require districts to include analyses of the effectiveness of the individual services they provide using LCFF funds.

Since our last high risk review, the State has met LCFF funding requirements. However, given our 2019 audit findings related to the ongoing lack of accountability for LCFF funds and a recent lawsuit that resulted in the Los Angeles Unified School District agreeing to redirect \$170 million in future spending toward intended students, K–12 education remains a high-risk issue. According to Education, this lawsuit was the result of a complaint process established in law and demonstrates that the process is working. Nevertheless, it also shows the need for the State to direct more attention to the use of LCFF funds. We will monitor our recommendations from our 2019 audit to determine whether their implementation addresses gaps in oversight by the State.

Agency Comments

The State Board agreed it would be helpful for state policymakers to know which state reforms are helping schools narrow the achievement gap, but it does not believe that a new system to establish a clear link between services and funding would be meaningful. In Report 2019-101, we recommended that the Legislature require Education to update its accounting manual to direct districts to track and report supplemental funds. We further recommended that the Legislature require Education to implement a mechanism for reporting the types of services those funds support. The State Board argued that this is asking parents to focus on accounting codes rather than student outcomes. We fundamentally disagree. As we note on page 57 of Report 2019-101, by collecting and reporting additional information about the districts' use of supplemental and concentration funding, the State could better ensure that it and other stakeholders understand how the districts' spending of these funds affects intended student groups and whether further action is necessary to close persistent achievement gaps.

DESPITE SOME PROGRESS, AFFORDABILITY ISSUES PERSIST WITHIN THE UC AND CSU SYSTEMS

Although the University of California (UC) and California State University (CSU) have made progress in meeting California's anticipated workforce needs, affordability of higher education remains a high-risk issue. Both the UC and CSU have increased graduation rates and will likely meet the Legislature's current enrollment goals. However, while recent undergraduate educational cost increases have been less dramatic than those during the previous decade, recent data and studies suggest that affordability continues to be a problem for students. For this reason, we will continue to monitor the UC's and CSU's progress toward ensuring all eligible students can afford higher education.

Background

In 1991 the Legislature declared that the State must commit to making higher education available and affordable for every Californian. However, from 1992 to 2017, undergraduate tuition increased by about 440 percent at the UC and 340 percent at CSU. Although there were several periods after the recession when tuition in both systems remained static, UC tuition has still increased by almost three times and CSU by two-and-a-half times since 1992, after adjusting for inflation.

We designated access and affordability in higher education as a high-risk issue in 2013. In addition to challenges associated with a lack of state funding and increased tuition, the Public Policy Institute of California (PPIC) identified risks to California's future workforce needs. In 2015 PPIC found that unless the UC and CSU substantially improved enrollment and graduation rates by 2030, California would have 1.1 million fewer college graduates than its economy will need.

Recent Fee Increases Compound Existing Challenges for Thousands of Students

Although state appropriations to the UC and CSU have increased in the last several years, expansions in campus fees have driven up the average cost of attendance. Since 2017 the Legislature has increased the General Fund appropriations for the UC and CSU by 10 percent and 24 percent, respectively. Nonetheless, the majority of campuses increased their fees during this same period. Campus fee adjustments vary widely. For example, UC San Diego increased its annual fees by almost \$550, a significant portion of which was to

Since 2017 the Legislature has increased the General Fund appropriations for the UC and CSU by 10 percent and 24 percent, respectively.

improve its athletics program.⁴ Cal Poly San Luis Obispo raised its annual fees by more than \$500, in part to provide additional health services to students. Other campuses had lower fee increases, such as \$10 at UC Riverside and at San Francisco State University. Table 2 provides a breakdown of the fee increases and the percentage of undergraduates they affected. Although changes since 2017 were generally less than \$400 per campus, they exacerbate tuition hikes from the previous decade and the resulting financial burden for resident students.

As a result of increased costs associated with higher education, some students and their parents are taking on more debt, despite the availability of financial aid programs. According to a 2019 CSU report, 73 percent of CSU undergraduates received financial aid in 2017, with most receiving sufficient amounts to cover their tuition for the year. Nonetheless, CSU reported that the average student loan amount for these students was \$7,800—a \$200 increase from the previous year. Based on the UC’s March 2019 report on financial support, the net cost of attendance declined or remained flat for low-income resident undergraduates in recent years.⁵ However, after adjusting for inflation, the cost of a UC or CSU education as a percentage of median family income has doubled since 1992. Further, UC reported that California resident borrowing increased for families of UC students at the lowest income levels.⁶ Specifically, for low-income parents who secured federal loans in 2017, the average loan amount increased from 2016 to 2017 by \$1,000 to a total of \$7,000—nearly a quarter or more of family income. These trends suggest that an undergraduate degree is becoming less affordable for some students, especially those at the lowest income levels.

Students may be making difficult choices to pay for higher education. In 2016 more than 40 percent of students in both systems reported having experienced food insecurity—reduced intake, reduced quality, or disrupted eating patterns. Similarly, 5 percent of UC students and 11 percent of CSU students reported experiencing homelessness one or more times during enrollment. According to CSU, students who reported food insecurity, homelessness, or both circumstances also experienced physical and mental health consequences that were associated with lower academic achievement. While the UC and CSU have initiatives to address this issue, students’ struggles underscore the importance of college affordability.

As a result of increased costs associated with higher education, some students and their parents are taking on more debt, despite the availability of financial aid programs.

⁴ UC policy requires certain fees to go through a student vote. In 2016 UC San Diego students participated in the vote that approved a fee increase to support the athletics program. As a result of the referendum, UC San Diego increased student fees in the 2018–19 academic year.

⁵ Net cost reflects the total costs of college, including tuition, fees, housing, and books, after subtracting grants and scholarships.

⁶ These families have annual incomes of less than \$29,000.

Table 2
Increases in Annual Fees Varied Greatly Across UC and CSU Campuses

CAMPUS	TOTAL FEE INCREASES FOR UNDERGRADUATES FROM 2017 THROUGH 2019	CAMPUS'S PERCENTAGE OF 2018 SYSTEMWIDE ENROLLMENT
UC Campuses		
UC Davis	\$499	13.7%
UCLA	387	13.2
UC Irvine	330	13.2
UC San Diego	549	12.8
UC Berkeley	366	12.7
UC Riverside	11	10.8
UC Santa Barbara	213	10.6
UC Santa Cruz	166	8.6
UC Merced	74	4.3
CSU Campuses		
CSU Northridge	\$102	8.2%
CSU Fullerton	74	8.2
CSU Long Beach	104	7.4
Sacramento State	164	6.8
San Diego State	50	6.4
San José State	131	6.3
San Francisco State	12	6.2
Cal Poly Pomona	57	5.9
CSU Los Angeles	129	5.8
Fresno State	4	5.2
Cal Poly San Luis Obispo	511	4.4
CSU San Bernardino	67	4.2
Chico State	458	3.9
CSU Dominguez Hills	109	3.3
CSU San Marcos	64	3.3
CSU East Bay	166	2.9
Stanislaus State	504	2.2
CSU Bakersfield	272	2.2
Sonoma State	156	2.1
Humboldt State	371	1.7
CSU Channel Islands	0	1.7
CSU Monterey Bay	100	1.5
CSU Maritime	60	0.2

Source: Auditor analysis of UC and CSU campus fee data.

Note: Amounts exclude tuition.

The UC and CSU Have Made Progress in Meeting Future Workforce Needs

Increases in graduation rates are beginning to address the projected shortfall of graduates necessary to meet the demands of California's workforce. In 2015 PPIC estimated that by 2030 California would have 1.1 million fewer college graduates than needed to meet economic demand. However, UC's cumulative four-year graduation rates increased from 63 percent for the cohort that entered the system in 2010 to 68 percent for the cohort that entered in 2014. CSU's four-year graduation rates have increased as well, rising from 19 percent to 23 percent for its cohorts in those same periods. The increases in both systems translates to an additional 11,800 graduates. Both the UC and CSU have developed initiatives to ensure continued progress and eliminate graduation disparities. According to recent PPIC testimony, the UC and CSU are on track to meet future workforce needs. Further, both systems appear likely to meet the Legislature's request that they enroll more students. However, because of the concerns about affordability we summarized above, higher education remains a high-risk issue.

Agency Comments

CSU reiterated that it has increased graduation rates and is meeting the Legislature's enrollment goals. It also noted that, in some cases, campuses have increased fees to offer programs and services of direct benefit to students. Further, CSU stated that it is keenly aware of the challenges students face and will continue to work on financial aid solutions to help students reach their educational goals.

The UC did not provide written comments to our draft report.

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CHAPTER 4

Health Provision and Oversight

ALTHOUGH CDCR HAS MADE PROGRESS IN SUCCESSION PLANNING, SIGNIFICANT DEFICIENCIES REMAIN IN ITS INMATE HEALTH CARE SYSTEM

The California Department of Corrections and Rehabilitation (CDCR) has resolved our concerns related to its inadequate succession planning, but its ability to provide adequate medical services to inmates remains uncertain. Since our last high risk report, CDCR has more fully implemented its succession plan designed to identify risks in the continuity of leadership. However, more than 10 years after a court order removed responsibility for inmate health care from CDCR because of inadequate care, nearly half of CDCR's institutions still have inmate health care systems under federal control. Moreover, according to the Office of the Inspector General (OIG), quality of care has declined in six institutions since its 2017 evaluation. Thus, CDCR has not made the significant improvements in the provision of inmate medical care necessary to remove it as a high-risk agency.

Background

CDCR operates 35 prisons that house about 127,000 inmates as of January 2019. In 2005 a federal court found that California's inmate health care system had violated the U.S. Constitution's prohibition against cruel and unusual punishment, resulting in significant harm to the State's inmate population. For example, a physician accused an inmate of faking symptoms of an injury and neglected to immobilize the patient, which may have caused the patient to suffer paralysis. To remedy concerns with the constitutionality of the care that CDCR provided, the court appointed a Federal Receiver (receiver) to take control of CDCR's health care system until CDCR could demonstrate the will, capacity, and leadership to maintain a constitutional system of care. In March 2015, a federal court ordered the receiver to make ongoing determinations about whether to return authority over institutions to CDCR after the OIG releases an independent report for each institution and after review of various internal CDCR data.

In addition to the risks associated with inadequate inmate health care, we designated CDCR as a high-risk agency in 2007 because of numerous vacancies in its management structure. Our 2007 high risk report found that 34 percent of CDCR's management positions

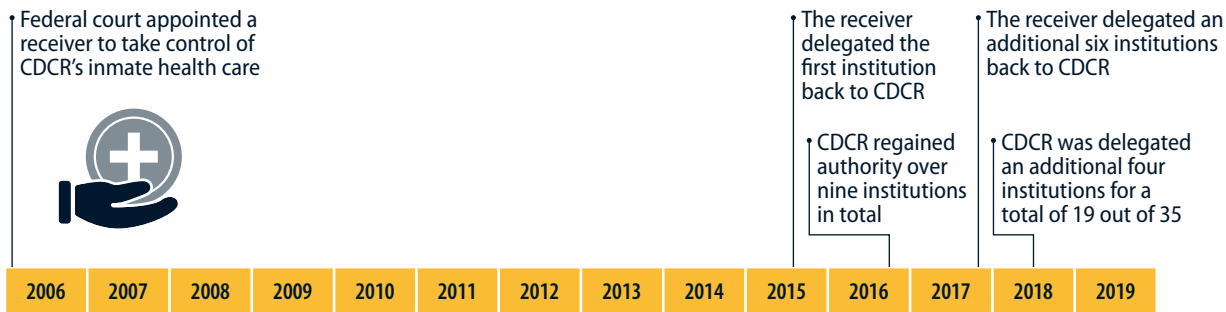
were either vacant or held by staff in an acting capacity. Our 2018 high risk update found that CDCR had made some progress in reducing the number of vacancies, but it did not have a program in place to ensure the availability and quality of future leaders.

CDCR Continues to Struggle to Provide Adequate Care for Its Inmates

Many CDCR institutions remain in federal receivership. In 2015 the receiver published a report indicating that although the quality of CDCR's inmate health care system had improved, CDCR still needed to complete a number of systemwide improvements. Further, the report indicated that the most significant and difficult work would have to take place at the institution level, where statewide plans confront the reality and inertia of decades of substandard care. As of October 2019, despite more than a decade of efforts, CDCR had yet to regain authority over 16 of its 35 institutions, as Figure 5 shows.

Figure 5

The Receiver Has Overseen CDCR's Inmate Health Care for More Than a Decade



Source: Receiver's reports to federal court and federal court orders.

Recent OIG medical inspection reports highlight challenges related to CDCR's ability to provide adequate care for its inmates. Although the OIG defers to the receiver on questions of constitutionality of care, it conducts comprehensive evaluations of the quality of inmate health care at the institution level. The OIG bases its assessment on qualitative and quantitative analyses of 15 indicators of inmate health care and assigns a rating to each. Based on the results of its review, it determines the overall quality of CDCR's delivery of medical care at each institution. In its most recent review cycle, which concluded in 2019, the OIG rated 15 of CDCR's 35 institutions as inadequate overall. The OIG's overall ratings at

six institutions had declined since its previous review cycle, which concluded in 2017. This suggests that CDCR is still facing challenges with providing inmates with adequate health care.

Inadequate health care heightens the likelihood of serious injury to patients and liability to the State. Four of the six institutions whose OIG ratings have fallen since 2017 also exhibited a decline in the quality of their health care provider performance. For example, in one institution, the OIG identified the unnecessary prescription of opioids and poor care of patients with diabetes. In another facility, it found that health care providers prescribed medications inappropriately and had significant difficulty delivering appropriate care for chronic illnesses. In CDCR's California Health Care Facility, the OIG reported strong patterns of deficiencies in assessments, decision making, documentation, and management of chronic medical conditions. According to the OIG's reports, these inadequacies indicate increased risk of harm within several CDCR institutions. CDCR remains a high-risk agency as a result of declines in patient care and its lack of substantial progress toward regaining management of health care at its institutions.

CDCR remains a high-risk agency as a result of declines in patient care and its lack of substantial progress toward regaining management of health care at its institutions.

CDCR Is Making Sufficient Progress in Addressing Future Leadership Challenges

CDCR has developed the plans and resources necessary to mitigate future vacancies in leadership positions. In recent years, CDCR has dedicated staff to creating and implementing a succession management program (succession program) intended to identify its needs and prepare employees for leadership appointments. As a component of the succession program, CDCR completed an agency wide succession plan in January 2018. Statewide policy defines six required elements for succession plans. For example, succession plans must identify competencies required to fill key leadership positions. CDCR's succession plan establishes a program for CDCR employees to create leadership development plans (development program) in collaboration with management. To support this activity, succession program staff will conduct a study for each CDCR division to identify its specific needs.

CDCR's decision to implement its succession program within its divisions demonstrates its commitment to controlling succession planning risk. CDCR's July 2017 analysis of the Division of Adult Institutions—responsible for housing adult inmates—found that more than 200 employees in critical positions, or 78 percent, were eligible for retirement within the next five years. This included positions at the director, deputy director, and warden levels. According to CDCR, as of December 2019, it had 31 participants at the Division of Adult Institutions working through the development

CDCR indicated that although the program is ongoing, it will be able to evaluate the program's initial effectiveness in December 2020.

program. CDCR indicated that although the program is ongoing, it will be able to evaluate the program's initial effectiveness in December 2020. It stated that the average projected time for employees to complete the activities set forth in their plans is two years. In the meantime, succession program staff have begun to implement the development program for employees in a second CDCR division and to lay the groundwork necessary to enroll employees within a third division. We will follow up with CDCR when it completes its first evaluation, but we no longer consider its succession planning as a contributing factor to its status as a high-risk agency.

Agency Comments

CDCR welcomed the insight our draft report provided and offered updated information about its succession management program, which we incorporated into the text.

HEALTH CARE SERVICES HAS NOT CORRECTED DISCREPANCIES IN ITS MEDI-CAL ELIGIBILITY SYSTEM OR PROVIDED ADEQUATE OVERSIGHT OF FUNDING FOR MENTAL HEALTH SERVICES

The Department of Health Care Services (Health Care Services) remains a high-risk agency because of significant concerns related to health care eligibility and mental health services. Specifically, Health Care Services has not taken sufficient action to correct deficiencies with its California Medical Assistance Program (Medi-Cal) eligibility system that resulted in improper payments; consequently the State could ultimately be liable for reimbursing the federal government millions of dollars. In addition, Health Care Services' lack of guidance resulted in local entities retaining hundreds of millions of dollars in unspent Mental Health Services Act (MHSA) funds intended to provide and improve mental health services throughout the State. Although Health Care Services has taken steps to address these concerns, much remains for it to do. As a result, Health Care Services remains a high-risk agency.

Background

Health Care Services is responsible for overseeing California's implementation of the federal Medicaid program, known as Medi-Cal. Medi-Cal provides funding for comprehensive health care services—such as emergency, laboratory, and preventive care—for low-income individuals and families. Although counties

perform some Medi-Cal functions such as application processing, Health Care Services maintains overall authority for the program and maintains the primary data system for assessing benefits eligibility. When we determined that Health Care Services would remain on the high risk list in 2018, we noted that it may have improperly identified more than 83,000 Medi-Cal beneficiaries as eligible for full benefits. Health Care Services' failure to ensure that only eligible recipients received Medi-Cal benefits represented a significant financial risk to the State.

Further, despite its responsibility to manage the State's efforts to support local mental health services, Health Care Services has not provided sufficient oversight of MHSA funds. Voters passed the MHSA in 2004 to expand services and treatment for those who suffer from or are at risk of mental illness. The MHSA imposes a 1 percent income tax on individuals earning more than \$1 million a year, and the California Mental Health Services Oversight and Accountability Commission estimates the tax has provided \$15 billion to fund mental health programs since the MHSA's passage. However, our August 2013 audit report, *Mental Health Services Act: The State's Oversight Has Provided Little Assurance of the Act's Effectiveness, and Some Counties Can Improve Measurement of Their Program Performances*, Report 2012-122, identified deficiencies in state oversight of the implementation of MHSA funding, including inadequate data collection from county programs. We further noted that Health Care Services assumed oversight of MHSA programs in 2012 and was responsible for correcting deficiencies related to its implementation. In our January 2018 high risk report, we concluded that Health Care Services remained a high-risk agency because it did not remedy ongoing concerns related to MHSA oversight. Compounding these issues, we subsequently identified \$230 million that local programs had failed to spend promptly.

Health Care Services' Continued Mismanagement of Medi-Cal Beneficiary Eligibility Could Require the State to Refund Millions of Dollars to the Federal Government

Health Care Services' failure to provide sufficient Medi-Cal oversight may result in state liability for improperly disbursed funds. In January 2017, the U.S. Department of Health and Human Services' Office of Inspector General (Inspector General) issued a report recommending that the State refund the federal government nearly \$10 million in improper Medicaid payments. In February 2018, the Inspector General also estimated that California distributed more than \$1 billion in Medicaid payments to ineligible and potentially ineligible beneficiaries. The report found that these deficiencies occurred because of errors in the process the State

Despite its responsibility to manage the State's efforts to support local mental health services, Health Care Services has not provided sufficient oversight of MHSA funds.

uses to determine eligibility and mistakes that caseworkers made. Finally, in May 2019, the Inspector General concluded that California should reimburse \$53 million in federal funds based on its estimate of unallowable Medicaid payments, including payments for deceased beneficiaries. Health Care Services stated that it does not agree with the Inspector General's calculations and is attempting to resolve the issue. Health Care Services has implemented interim measures to identify improper payments to deceased beneficiaries. However, it does not anticipate that it will complete its analysis to determine the amount it owes the federal government until March 2020. According to Health Care Services, some reimbursements will come from the respective health care plans that received the payments while others will come from the State's General Fund.

Health Care Services continues to struggle to address discrepancies in its Medi-Cal eligibility system that may result in ongoing costs to the State. In our October 2018 audit report, *Department of Health Care Services: It Paid Billions in Questionable Medi-Cal Premiums and Claims Because It Failed to Follow Up on Eligibility Discrepancies*, Report 2018-603, we identified discrepancies between the State and county systems, which indicate more than 453,000 individuals may have been improperly receiving benefits. Because it did not resolve those discrepancies, Health Care Services paid at least \$4 billion in questionable Medi-Cal payments from 2014 through 2017. Further, our June 2019 audit report, *State of California: Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2018*, Report 2018-002, found that Health Care Services has not implemented the controls or processes necessary to identify Medi-Cal eligibility problems. As a result, although the populations Medi-Cal serves and the funding it receives continue to grow, Health Care Services had not demonstrated substantial progress as of September 2019 toward addressing deficiencies.

The State's recent decision to expand Medi-Cal services to undocumented young adults may exacerbate Health Care Services' eligibility determination problems.

Finally, the State's recent decision to expand Medi-Cal services to undocumented young adults may exacerbate Health Care Services' eligibility determination problems. The State currently provides services to 13 million California residents and—beginning in January 2020—will extend those benefits to some young adults from the ages of 19 through 25 regardless of immigration status. Health Care Services estimates this expansion will add up to 90,000 individuals to the system by the end of fiscal year 2019–20. However, past expansions of the Medi-Cal system have negatively affected Health Care Services' efforts to establish eligibility accurately. For example, in our October 2018 report, three of the counties we examined—Los Angeles, Sacramento, and Stanislaus—reported that the 2014 expansion to Medi-Cal eligibility to implement the Patient Protection and Affordable Care Act (Affordable Care Act) resulted in Medi-Cal payment discrepancies. Although Health Care Services

plans to update its eligibility and enrollment systems to address the new state requirements for 2020, it will continue to face challenges because of an increasing number of users of medical services.

Health Care Services Has Not Fully Completed Efforts to Provide Adequate Guidance or Oversight Regarding the Use of MHSA Funds

Health Care Services has not fully implemented key oversight functions necessary for the successful implementation of the MHSA. For example, in our February 2018 audit report, *Mental Health Services Act: The State Could Better Ensure the Effective Use of Mental Health Services Act Funding*, Report 2017-117, we noted that despite having responsibility for MHSA since 2012, Health Care Services had not developed processes to ensure that local mental health agencies report on MHSA spending or to recover unspent funds from local mental health agencies. We found that as a result, these agencies had amassed hundreds of millions of dollars in unused funds that could otherwise have supported critical mental health services. Although Health Care Services has since implemented procedures to address some of our concerns—including a process to withhold MHSA funds from local mental health agencies that fail to submit their annual reports on time—it indicated that it will not implement regulations to provide better guidance to local agencies regarding how to spend MHSA funds until at least March 2020. Further, our 2018 report identified that Health Care Services lacked an effective audit process to ensure that local mental health agencies spend MHSA funds appropriately. Following our audit, Health Care Services implemented a program review process to ensure local mental health agencies comply with MHSA requirements; however, it indicated that it will not finalize its MHSA fiscal audit regulations until December 2020.

Health Care Services has also not fully addressed oversight deficiencies we identified in our August 2013 report. For example, although Health Care Services has made efforts to improve data collection from counties using MHSA funds, delays since 2013 have deprived it of information that would have supported informed decision making. According to Health Care Services, it hired a vendor to help improve the quality of the data it collects, but the vendor reported that local mental health agencies had missing and anomalous data. As a result, the vendor recommended the creation of improved data infrastructure and maintenance, which led Health Care Services to extend the vendor's project through fiscal year 2019–20. Health Care Services estimates that, with the assistance of the vendor, it will complete data quality improvements by December 2020. Although Health Care Services has reported progress in improving its oversight, these delays in implementing needed reforms warrant its continued designation as a high-risk agency.

Health Care Services implemented a program review process to ensure local mental health agencies comply with MHSA requirements; however, it will not finalize its MHSA fiscal audit regulations until December 2020.

Agency Comments

Health Care Services generally disagreed with our conclusion that it remains a high-risk agency because of lack of progress in improving its Medi-Cal eligibility system and strengthening oversight for funding of mental health services. It highlighted several steps it has taken to mitigate potential Medi-Cal eligibility discrepancies, including initiating a pilot program in 2019 to reduce such discrepancies through work with five counties. However, Health Care Services has generally not fully implemented the recommendations from Report 2018-603 that we cite in our assessment and upon which we base, in part, the conclusion that it remains a high risk agency. Specifically, we determined in October 2019 that Health Care Services had not yet substantiated that it had fully implemented the recommendation that led to the pilot program. Health Care Services also noted that it has implemented several of our audit recommendations related to MHSA funding oversight, though it acknowledged that it has not yet finalized regulations pertaining to fiscal audits. It also provided several updates and corrections to information in the draft report, and we updated the text when in our judgment it corrected errors or added appropriate clarity or context. While we appreciate that Health Care Services acknowledged the risk related to these issues and has indicated its commitment to resolving them, we stand by our conclusion that its actions at this time are insufficient to warrant removal from the high risk list. We will continue to monitor Health Care Services' corrective measures as it analyzes results from its pilot programs and promulgates regulations.

PUBLIC HEALTH HAS NOT ADDRESSED CERTAIN CONCERNS THAT COULD AFFECT THE HEALTH AND SAFETY OF PATIENTS AND THE PUBLIC

The California Department of Public Health (Public Health) remains a high-risk agency because it has not implemented a number of our recommendations from past reports. Specifically, we made recommendations to address concerns with Public Health's inadequate complaint handling, staffing deficiencies, and failure to issue timely citations. These issues—some of which we first reported more than five years ago—collectively represent a serious detriment to the State and to the safety of patients in long-term care facilities.

Background

Public Health's duties include protecting patient safety in hospitals and skilled nursing facilities. Our 2018 high risk update concluded that Public Health remained a high-risk agency because of

incomplete changes it made to processes that affect the life and safety of residents in health care facilities. Further, although we noted in 2018 that Public Health had made progress toward implementing recommendations from our previous audits, we concluded that as of November 2019, eight recommendations from five audits have gone unimplemented for more than a year, and Public Health stated it would not implement three other recommendations.

Public Health Has Not Taken Sufficient Action to Address Risks Related to Health Care Facilities

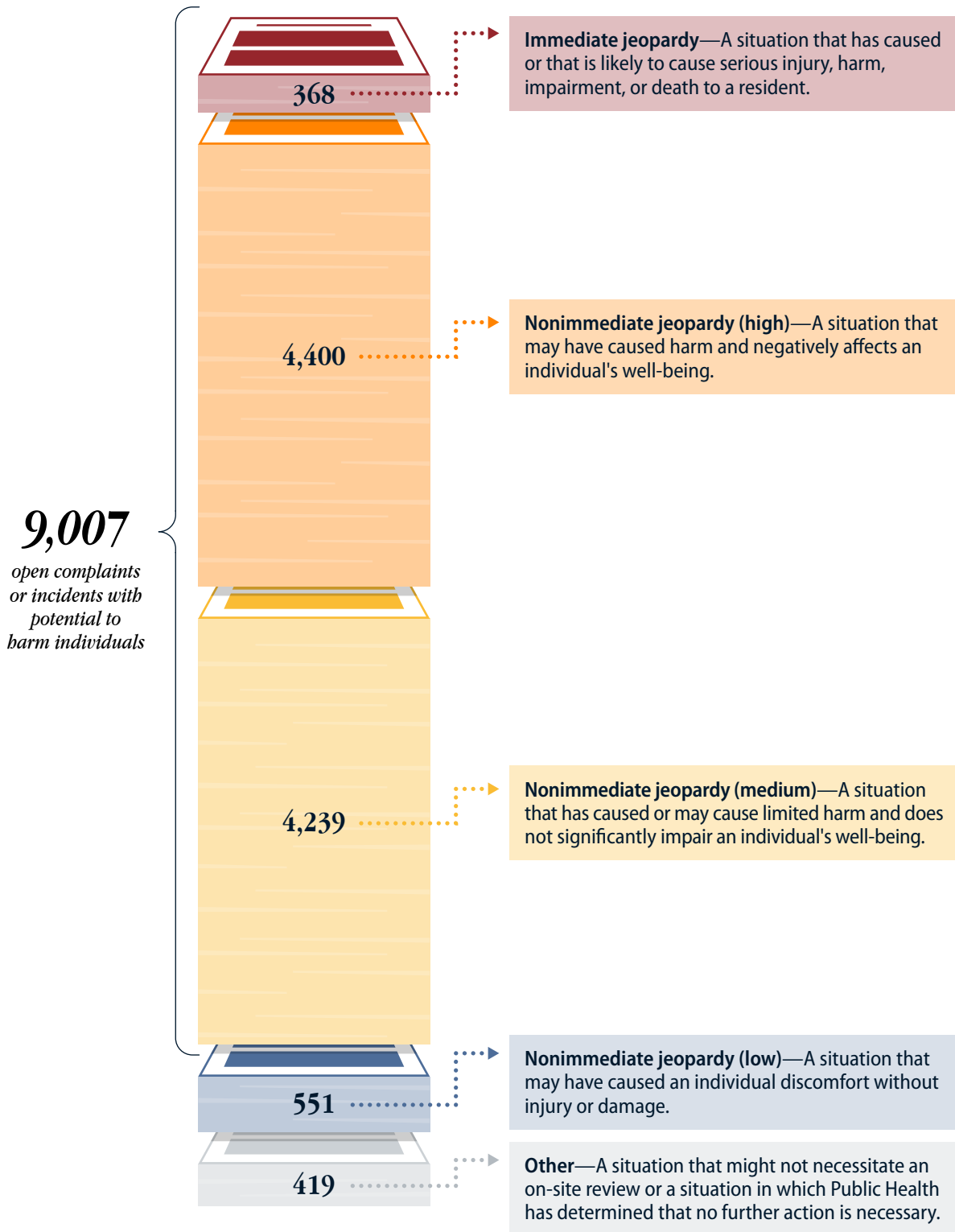
Public Health has not implemented recommendations designed to protect patients in health care facilities and to improve its handling of critical complaints and investigations. In our October 2014 audit report, *California Department of Public Health: It Has Not Effectively Managed Investigations of Complaints Related to Long-Term Health Care Facilities*, Report 2014-111, we found that Public Health did not complete investigations of complaints within reasonable periods. As of April 2014, Public Health had about 10,000 open complaints and facility-reported incidents—called *entity-reported incidents*—related to long-term health care facilities. It also had 1,000 open complaints against individuals, such as home health aides or nurse assistants (certified individuals), who provide care in health care facilities.⁷ As Figure 6 demonstrates, this backlog existed despite Public Health's records indicating that a high number of complaints refer to situations that could represent a safety risk to a resident. For instance, immediate jeopardy complaints indicate that a situation in a long-term health care facility has or is likely to cause death, serious injury, harm, or impairment to a resident.

As a result of our findings, we recommended that Public Health establish specific time frames for completing investigations of incidents and complaints. We also recommended that Public Health ensure that its district offices have adequate staffing levels for licensing and certification responsibilities and that its district offices follow procedures requiring supervisor review and approval of investigations of complaints and incidents. As of November 2019, Public Health has not implemented our recommendations related to time frames and staffing.

Public Health has not implemented recommendations designed to protect patients in health care facilities and to improve its handling of critical complaints and investigations.

⁷ Public Health certifies and/or licenses nurse assistants, home health aides, hemodialysis technicians, and nursing home administrators.

Figure 6
As of April 2014, Public Health Had More Than 9,000 Open Complaints or Incidents With Potential to Harm Individuals



Source: Auditor analysis of Public Health data as of April 11, 2014, from Report 2014-111.

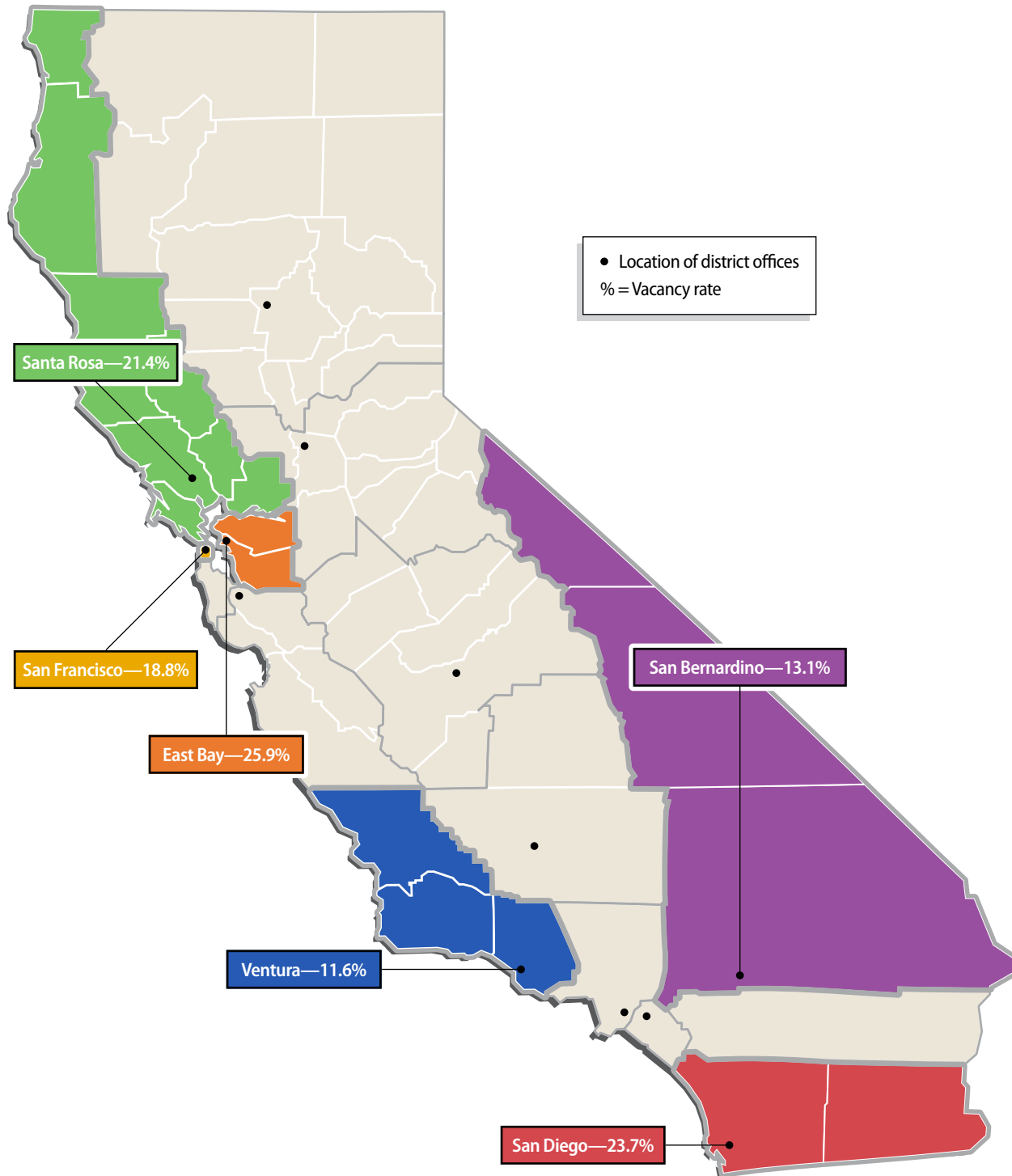
In fact, despite the risks posed to the public, Public Health indicated that it did not intend to implement our recommendations related to establishing specific time frames for complaint processing. An assistant deputy director at Public Health explained that time frames for facility-reported investigations are not mandated by statute or by the federal Centers for Medicare and Medicaid Services and that establishing time frames might limit Public Health's flexibility in prioritizing other tasks. However, the time necessary for Public Health to process complaints against certified individuals has increased. Although Public Health reported that it was able to process 79 percent of complaints against certified individuals within 90 days during the third quarter of fiscal year 2016–17, its processing rate fell to 42 percent as of the first quarter of fiscal year 2018–19. Public Health stated that it plans to implement a quality improvement project over the next 18 months in an effort to clear backlogged complaints and investigations. Additionally, in its response to this assessment, Public Health noted that it now agrees with our 2014 recommendation. Until it takes steps to ensure that it can process complaints in a reasonable time frame, Public Health will continue to jeopardize the safety of California's long-term care patients.

Public Health's ongoing staffing issues lead us to conclude that its ability to remedy its backlog and ensure the safety and well-being of residents in care facilities remains a high-risk issue. All four district offices we visited during our 2014 audit reported that they received more complaints than current staffing resources allowed them to complete without working overtime. Public Health's staffing remains an issue; its data show that as of June 2019, six districts had office-wide staff vacancy rates greater than 10 percent, as Figure 7 demonstrates. Additionally, several districts continue to have vacancy rates of 20 percent to 30 percent for health facilities evaluator nurses, who investigate complaints.

In our May 2018 audit report, *Skilled Nursing Facilities: Absent Effective Oversight, Substandard Quality of Care Has Continued*, Report 2017-109, we identified an additional area of concern related to Public Health's handling of care facilities. State law requires that if Public Health determines that a violation warrants a citation, it must issue that citation within 30 days of completing its investigation. However, our audit noted that in a 10-year period, Public Health had issued more than 1,100 citations at least six months after it identified deficiencies. We recommended that Public Health issue citations in a timely manner, especially for immediate jeopardy deficiencies that did result or could have resulted in death, serious injury, or harm to patients. According to the assistant deputy director, Public Health is developing policies and procedures for issuing citations, including a template that it will formalize into policy after management review.

Public Health's ongoing staffing issues lead us to conclude that its ability to remedy its backlog and ensure the safety and well-being of residents in care facilities remains a high-risk issue.

Figure 7
Six Public Health District Offices Continue to Have High Office-Wide Staff Vacancy Rates



Source: Public Health data on vacancy rates as of June 2019.
Note: We defined *high vacancy* as a vacancy rate greater than 10 percent.

Not fully implementing this recommendation creates the risk of loss of life, significant injury, or a reduction in the health and safety of residents of care facilities.

Despite our ongoing concerns, Public Health has made significant progress in implementing improvements related to supervisory review. Our 2014 audit found a lack of adequate supervisory review of complaints at a district office. We recommended that Public Health ensure that all district offices follow procedures requiring supervisory review of complaints and investigations into facility-related incidents. Public Health's review of complaints and investigations from January through March 2019 showed that all district offices were submitting incidents and complaints for supervisory review and that each complaint was undergoing review by multiple supervisors.

Agency Comments

Public Health highlighted three recommendations we made in prior audits that were part of our assessment that it remained a high-risk agency. Public Health stated that it agreed with all three recommendations and provided updates on measures it is taking to address them, such as increasing recruitment efforts for district offices by offering remote work for positions in hard-to-reach geographic areas. As Public Health notes, its activities related to its progress on these recommendations is ongoing; therefore, we are retaining Public Health on the high risk list.

DESPITE CONTINUED UNCERTAINTY OVER THE FUTURE OF THE AFFORDABLE CARE ACT, COVERED CALIFORNIA HAS IMPROVED ITS FINANCIAL STABILITY AND IS NO LONGER A HIGH-RISK AGENCY

Covered California has taken adequate steps to mitigate the risk from changes to the Affordable Care Act and has stabilized its financial position. Covered California exceeded its enrollment forecasts and had revenue above its expenditures for fiscal year 2017–18, and is currently maintaining adequate reserves. In addition, Covered California is on track to exceed its enrollment forecasts again for fiscal year 2018–19, which will position it for continuing stability. Although uncertainty about the future of the Affordable Care Act remains, we are removing Covered California from the high risk list and will continue to monitor both it and the act to determine if a reevaluation is necessary.

Despite our ongoing concerns, Public Health has made significant progress in implementing improvements related to supervisory review.

Background

Covered California is California's health insurance exchange. The Affordable Care Act created the state exchanges in 2010 and the federal government partially subsidizes health insurance available through the state exchanges for certain purchasers. State and federal laws require Covered California to be self-supporting without General Fund aid, and thus it depends on revenue from an assessment on health plan premiums.

We first designated Covered California as high risk in our July 2013 report titled *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. At that time, Covered California's future solvency was uncertain. In our report, we explained that because of restrictions at the federal and state level, Covered California was required to support itself without the aid of federal or state funding. Covered California remained on our high risk list in 2018 because of similar concerns regarding financial viability in the face of potential changes to the Affordable Care Act.

Covered California Has Made Significant Progress in Ensuring Its Continued Availability to Californians

Since our last high risk report, Covered California exceeded its enrollment forecast. Covered California updates its enrollment forecasts annually based on its enrollment history and the analyses of health insurance market experts. Based on our review of the enrollment forecasts it provided for fiscal years 2017–18 and 2018–19, we noted that Covered California's actual enrollment rates exceeded its highest forecasted projections for fiscal year 2017–18 and that enrollment for fiscal year 2018–19 is on track to exceed its projections as well. Enrollment rates exceeding Covered California's projected rates suggest that its projections are conservative and are based on adequate assumptions. Covered California appears positioned to anticipate changes to its enrollment and to take necessary action.

Although it anticipated the potential for a decline in new enrollments as a result of federal changes to the Affordable Care Act in 2017, Covered California's high retention rate allowed it to maintain a prudent reserve. Covered California anticipated that the removal of the individual mandate would result in enrollment

Covered California's actual enrollment rates exceeded its highest forecasted projections for fiscal year 2017–18 and that enrollment for fiscal year 2018–19 is on track to exceed its projections as well.

reductions that would range between 7 percent and 26 percent.⁸ Covered California's preliminary analysis shows new enrollments for 2019 coverage decreased significantly—nearly 24 percent from the previous year. However, according to data Covered California provided, record-high renewal rates during the same year offset the impact of this decrease, resulting in less than a 1 percent net decrease in total enrollment. In addition, we reviewed Covered California's audited financial statements for fiscal year 2017–18 and found that its revenue exceeded its expenditures by nearly \$4 million. Further, for fiscal years 2018–19 and 2019–20, Covered California projects that its revenue will continue to exceed its expenditures, suggesting its financial position is stable.

Covered California is also planning for future uncertainty by ensuring that it maintains an adequate reserve balance. Specifically, one of Covered California's guiding financial principles is to maintain a reserve balance that is sufficient to cover its financial obligations and allow it time to adjust expenditures if necessary. Covered California maintained a prudent reserve; it began fiscal year 2019–20 with a reserve equal to more than 10 months of expenditures. In addition to its operating reserve, Covered California maintains a separate reserve specifically for capital projects, such as facilities costs that it will incur because of expiring lease agreements. Covered California began fiscal year 2019–20 with about \$40 million in capital reserves. Finally, Covered California's ability to raise its revenue by increasing the enrollment fees paid by health insurance companies further mitigates the risk of a drop in enrollment. Covered California's ability to exceed its enrollment projections, adjust its revenue, and maintain reasonable expenditures and reserves mitigates our concern regarding its viability. Therefore, as stated previously, we are removing Covered California from our high risk list. However, we will continue to monitor any changes to its enrollment and the impact of any such changes on its finances, including its reserves.

Agency Comments

Covered California agreed with our conclusion that it is no longer a high-risk agency. It stated that it is committed to maintaining strict standards to ensure Californians can continue to rely on Covered California for years to come.

⁸ The *individual mandate* is a fee assessed on individuals who choose not to carry health insurance. Although Congress repealed the federal individual mandate, the Governor signed a bill in California in 2019 to create such a mandate at the state level.

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CHAPTER 5

Human Resources

CALSTRS IS A HIGH-RISK AGENCY BECAUSE OF THE SIGNIFICANT TIME NECESSARY TO REDUCE ITS UNFUNDED LIABILITY

The California State Teachers' Retirement System (CalSTRS) is a high-risk agency in part because of the more than 26 years it projects will be required to fully fund the State's retirement obligations to California's teachers. Although CalSTRS manages a system to provide retired teachers a guaranteed lifetime retirement income, it does not have the assets to cover these expected payments. In order to address these shortfalls—or its *unfunded liability*—CalSTRS is currently implementing a 2014 funding plan. Although it intends this plan to essentially eliminate its unfunded liability by 2046, the plan is subject to market volatility. CalSTRS anticipates that its unfunded liability will not begin to decrease until around 2026.⁹ Further, successful implementation of the funding plan relies on CalSTRS' investments achieving their expected levels of return over the remaining 26 years of the plan. Finally, state law limits CalSTRS' ability to modify state and employer contribution rates, and its current authority may not be sufficient to reach its funding goals. Therefore, CalSTRS is a high-risk agency for the State.

Background

CalSTRS is responsible for providing and managing California's comprehensive retirement packages for its teachers, and it is the second-largest public pension fund in the nation. Its primary retirement plan, the Defined Benefit Program (benefit program), provides income to its retired members and receives funding from the State, employers such as school districts, and active members. CalSTRS uses the funding it receives to generate investment income through its diverse portfolio of assets. As a pension fund, CalSTRS operates on long time horizons, working to guarantee benefit payments in the future after its members retire. According to CalSTRS, the most financially prudent way to provide such benefits is to fund the benefit program fully by maintaining sufficient assets to cover all payments the program is obligated to make.

⁹ The funding plan does not address a small portion of CalSTRS' liability related to work performed by members after July 2014. However, if the plan succeeds, CalSTRS will be more than 99 percent funded in 2046, which we consider in this report to be full funding.

However, until the funding plan accumulates a sufficient amount of assets to reduce the benefit program's current unfunded liability, the program will remain billions of dollars short of the funds it will need to pay for CalSTRS benefits. This substantial unfunded liability will likely persist for more than a decade.

In our September 2013 high risk assessment, we found that CalSTRS's funding status—the ratio of assets to retirement liabilities—had significantly worsened during the preceding 11 years, from 98 percent funded in 2001 to just 67 percent funded in 2012. According to CalSTRS, this drop largely occurred during the financial crisis and market downturn of 2008 and put the benefit program at risk of running out of assets unless it implemented a different funding structure. However, our 2013 report noted that unlike the similar California Public Employees' Retirement System (CalPERS), CalSTRS did not have the authority to adjust contribution rates at that time. We concluded that a delay in increasing contribution rates could increase the difficulty of reversing the program's downward trend and require significant additional funding from the State.

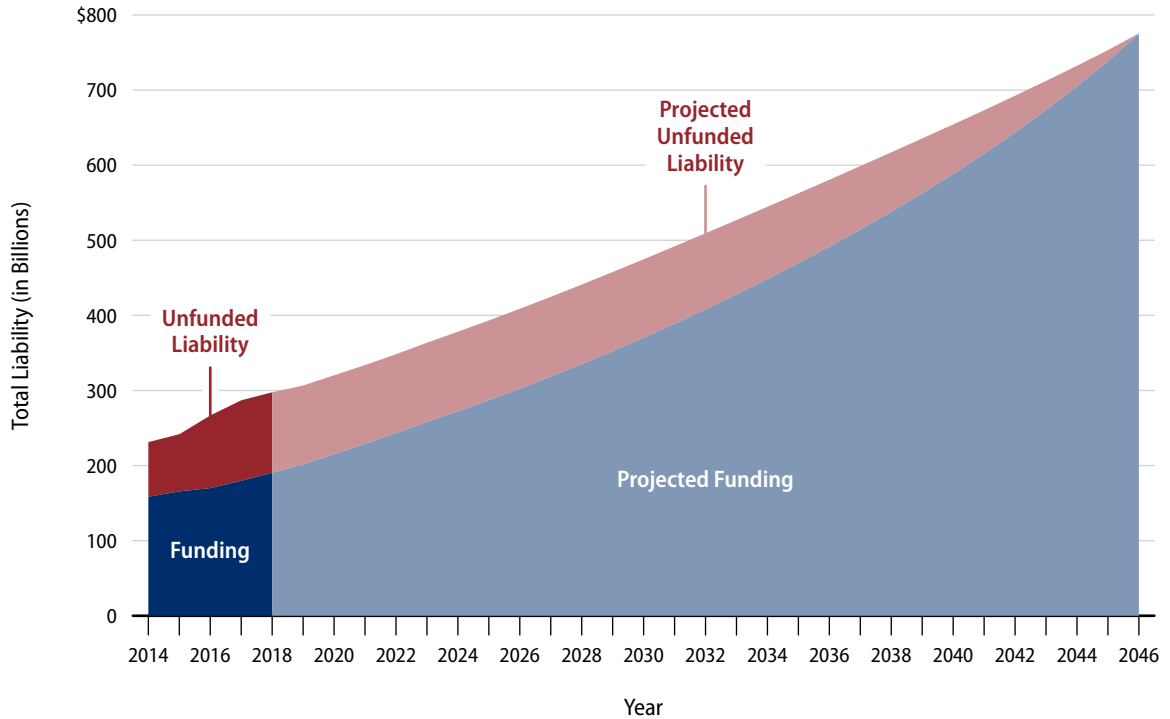
In 2014 the Legislature addressed this deficiency through a plan that increased active member rates and allowed CalSTRS to gradually increase state and employer contributions by fixed percentages of employee compensation. The LAO indicated that this funding plan was a major accomplishment, and CalSTRS reported in June 2019 that it was working as intended. However, in our January 2018 report, we identified several concerns related to the time necessary for the funding plan to fully eliminate the unfunded liability. According to its June 2019 report to the Legislature, CalSTRS stated that it has a 50 percent likelihood of reaching its full funding goal in 2046. However, the plan's returns in the last few years will have a significant effect on the final outcome.

Successful Implementation of the Funding Plan Will Require CalSTRS to Achieve Decades of Anticipated Returns

The funding plan operates on long time horizons, so lower-than-expected investment returns and longer-than-expected retiree lifespans may increase CalSTRS's long-term liabilities. Currently, CalSTRS estimates that the unfunded liability will not significantly decrease until 2026, the point at which it will begin to decline. Figure 8 shows the changing size of the State's unfunded liability from the plan's inception through 2046. CalSTRS predicts that the benefit program will be less than about 80 percent funded by 2031 and will only reach about 90 percent funding less than seven years before its plan's 2046 target for full funding.

CalSTRS estimates that the unfunded liability will not significantly decrease until 2026, the point at which it will begin to decline.

Figure 8
 Although CalSTRS Expects to Reach Full Funding for Its Benefit Program, Its Funding Plan Will Take Many Years to Achieve This Goal



Source: Historical data and projections from CalSTRS.

CalSTRS performs projections of its funding levels using assumptions regarding factors ranging from future investment returns to employee lifespans. However, since the funding plan’s passage, CalSTRS changed some of its assumptions. For example, CalSTRS lowered its assumed investment return in recent years from 7.5 percent to 7 percent, and it updated its mortality assumptions to account for increased life expectancy for future retirees. As a result, the LAO stated that the plan could expose the State to larger liabilities than thought possible when the Legislature passed it in 2014. However, the LAO also noted that these new assumptions will ultimately make achieving full funding more likely. According to CalSTRS, the benefit plan’s position was further strengthened when the Legislature allocated more than \$3 billion in supplemental funds to CalSTRS over the last two fiscal years, which CalSTRS staff indicated would increase the likelihood of reaching full funding at the plan’s end date.

Although CalSTRS has made progress in implementing the funding plan for the last six years, the potential for volatility in investment returns remains one of the major obstacles to achieving full funding of the benefit program throughout the plan's lifetime.

Although CalSTRS has made progress in implementing the funding plan for the last six years, the potential for volatility in investment returns remains one of the major obstacles to achieving full funding of the benefit program throughout the plan's lifetime. Investment returns may vary significantly from year to year; however, CalSTRS projects that the pension fund will earn its assumed return over the long term. However, even with the lowered assumptions we describe above, CalSTRS may experience years when its investments earn less than its projected rate of return, which may delay its ability to achieve full funding. For instance, CalSTRS reported investment returns of less than 7 percent in nine of the last 20 years. Investment staff noted that the 7 percent assumption is a median value; thus, the portfolio will return less than 7 percent about half the time. However, failing to achieve anticipated returns can have significant impacts on the success of the funding program, depending on when shortfalls occur. For example, CalSTRS calculated in November 2019 that a single year of severe investment losses similar to those experienced in the 2009 recession could cause the benefit program to risk running out of assets in the following decades and require another funding plan or an extension of the current plan to remain solvent.

Moreover, past performance illustrates the possibility that CalSTRS may not even achieve an average return of 7 percent over the course of the funding plan. For example, although staff indicated that CalSTRS returned more than 8 percent per year on average in the 30-year period ending in June 2019, its average return was only 6.2 percent in the most recent 20 of those fiscal years—a rate that CalSTRS calculated would create difficulty in fully funding the benefit program by 2046. Investment staff noted that the average of the previous 20 years of returns was unusually low because of the portfolio's losses in fiscal year 2008–09 and that CalSTRS's portfolio is now better positioned to minimize losses in future economic downturns. However, even slightly missing investment benchmarks over long periods could potentially cause the funding plan to fail to achieve funding targets. CalSTRS estimates that there is a 50 percent chance such a shortfall will occur, demonstrating the uncertainty inherent in the funding plan.

Finally, although the funding plan grants CalSTRS limited authority to adjust contribution rates, CalSTRS has acknowledged that scenarios exist when low investment returns would lead to insufficient revenue to cover requirements. Under the funding plan, CalSTRS has the ability to make small annual adjustments—up to 1 percent of employee compensation annually, depending on the category of contribution—as long as the contribution rates stay under proscribed caps. CalSTRS' June 2019 report noted that while the current contribution rate-setting authority is expected to allow CalSTRS to meet funding goals, it is possible that the authority may

become insufficient in the future. According to the report, acting quickly in such a situation would strengthen funding levels sooner, as providing additional contributions soon after a period of negative investment returns would potentially allow CalSTRS to invest when market prices are low. However, under the current plan, CalSTRS can make only limited contribution rate adjustments after such a downturn, increasing the risk that poor investment returns could leave the benefit program unable to achieve full funding.

Under the current plan, CalSTRS can make only limited contribution rate adjustments after such a downturn, increasing the risk that poor investment returns could leave the benefit program unable to achieve full funding.

Agency Comments

CalSTRS agreed with our assessment of risks related to its benefit program and stated that its financial position is stronger than in recent years due to legislative action. It also offered several minor text updates. We reviewed the suggestions and incorporated into the report those that, in our professional judgment, provided necessary updates, context, or clarification.

OPEB LIABILITY REMAINS A HIGH-RISK ISSUE BECAUSE OF ITS CURRENT FUNDING LEVEL AND INVESTMENT VOLATILITY

The State's other postemployment benefits (OPEB) liability remains a high-risk issue because of the length of time necessary to complete its multibillion dollar plan to fund retiree health care. Although the State is currently collecting employee and employer contributions designated to support the health expenses of future retirees, state law generally prevents using investment revenue from these assets until 2046.¹⁰ Further, the June 2019 OPEB fund balance of about \$2 billion is far short of the State's approximately \$85 billion projected liability. The volatile nature of investment returns over the remaining 26 years of the plan also increases the risk that the State may need to provide additional funding.

Background

The State provides health and dental benefits as part of the retirement package it offers state employees who reach certain thresholds of service. The State generally pays the majority of health insurance premiums and at least a portion of dental premiums for retirees, depending on their years of service and dates of hire.

¹⁰ The OPEB fund is divided into subaccounts based on the bargaining units that contribute to it. The State can use the investment revenue from these subaccounts only after they individually achieve full funding or after 2046.

In addition, benefits for certain retirees include similar health premium coverage for family members, also depending on retirees' years of service and dates of hire. These benefits represent large financial outlays by the State. For example, in fiscal year 2017–18, the State paid more than \$2.2 billion in OPEB expenses. The State tracks and reports its calculated future OPEB expenses as a liability, which as of the end of fiscal year 2017–18 totaled about \$85 billion.

These significant costs resulted in the need for the State to adopt a new strategy to fund OPEB. In our 2009 high risk report, we indicated that without active steps to address OPEB funding, the

Agencies' Roles in Executing the State's OPEB Prefunding Plan

- **CalHR** administers state law related to personnel and serves as the Governor's representative in negotiations with employee organizations on issues such as OPEB contributions.
- **Finance** oversees the State's financial and business services and collaborates with CalHR to project OPEB funding needs as part of the bargaining process with employees.
- **CalPERS** invests the State's funds set aside for OPEB along with funds for various other public entities.

Source: State law and discussions with CalHR, Finance, and CalPERS staff.

State's liability could grow so rapidly that it could potentially affect the State's credit rating. The State began researching options in 2008 to set aside funds for OPEB in advance, but it did not fully implement a plan until 2018. The State intends for this plan to eliminate its unfunded OPEB liability by about 2046. As of July 2018, nearly all state bargaining units began prefunding OPEB through monthly employee contributions—typically from 1 percent to 4 percent of employee pay—with the State providing matching contributions. Under this plan, the State deposits these contributions to a trust. CalPERS invests the contributions, the revenue from which state law authorizes for OPEB expenditures either when specific bargaining units reach 100 percent funding or after July 2046. The text box describes the roles of key state agencies involved in executing the State's prefunding plan.

Despite the Creation of the Prefunding Plan, Obstacles Remain to Fully Funding OPEB Liabilities

Although the State instituted a long-term plan intended to fully fund OPEB through state and employee contributions, the State's OPEB fund's balance remained at \$2 billion as of June 2019, less than 3 percent of the most recently calculated liability of about \$85 billion. We reported in our 2018 high risk report that Finance projected that the unfunded liability would begin to decrease in 2026. However, until this decrease occurs, OPEB will continue to represent a substantial unfunded liability.

The State's ability to achieve its funding goals over the next 26 years is also subject to investment volatility. The State uses the CalPERS investment strategy with the highest expected returns for its OPEB investments, which CalPERS projects to return about 7.6 percent annually over a 60-year horizon. However, according to CalPERS, this strategy has the highest predicted volatility of

the available strategies and may return more or less than the projected 7.6 percent. For example, the strategy's annualized return was only about 4.9 percent from its inception in 2007 through June 2019—well under the assumption. Comparatively, in the most recent 10 fiscal years of that period, its annualized returns were above 9 percent. CalPERS staff explained that such volatility is normal for investment funds and that the 7.6 percent return projection is a long-term estimate based on the best available information at the time CalPERS formulated its projections; accordingly, the 7.6 percent return is not guaranteed. Further, they indicated that the State's OPEB fund did not experience as low of returns as the overall strategy during the past 12 years because the State only started investing in the trust fund after the recession in 2009. However, in part because of contributions being subject to investment volatility, the State's OPEB liability remains a high-risk issue.

Agency Comments

Finance did not agree that the OPEB liability is a high risk for the State. It acknowledged that OPEB is a substantial unfunded liability but noted that there has already been a reduction in the liability since 2017. Nevertheless, the long time horizon, investment volatility, and current funding level lead us to conclude that the OPEB liability remains a high-risk issue. Finance also provided updated information related to the size and nature of the liability that we incorporated into the text.

CalPERS did not object to our description of the OPEB issue but offered suggestions to clarify the text of our report. We reviewed the suggestions and incorporated into our report those that, in our judgement, provided necessary context or clarification.

CalHR did not provide written comments to our draft report.

STATEWIDE PROGRESS IN WORKFORCE AND SUCCESSION PLANNING WARRANTS REMOVAL OF THIS ISSUE FROM THE STATE HIGH RISK LIST

The California Department of Human Resources (CalHR) has made significant progress toward addressing our concerns pertaining to workforce and succession planning. Based on the information it provided, CalHR implemented our recommendations and increased the resources and training it provides to state agencies. These changes, coupled with generally low retirement and voluntary separation rates among employees, have lowered the

CalHR has made significant progress toward addressing our concerns pertaining to workforce and succession planning—it implemented our recommendations and increased the resources and training it provides to state agencies.

risk to the State of inadequate succession planning. Therefore, we are removing this issue from the state high risk list. However, we will continue to monitor succession planning to determine if reevaluation is necessary.

Background

CalHR is responsible for all issues related to state employee salaries, benefits, training, recruitment, and retention. CalHR requires all state agencies to have workforce and succession plans. These plans provide agencies with the ability to forecast future workforce needs; to develop strategies to ensure that they have talented, competent workforces; and to mitigate the loss of institutional knowledge through attrition. We identified concerns with the State's workforce and succession planning in our 2007 high risk assessment. In our 2018 assessment, we noted that a lack of planning combined with an increase in retirements could impair the delivery of important government services and reduce the overall efficiency of state government programs.

CalHR Has Improved the State's Workforce and Succession Planning

CalHR has taken significant steps to improve the State's workforce planning. In May 2016, CalHR fully implemented the recommendations from our report, *High Risk: State Departments Need to Improve Their Workforce and Succession Planning Efforts to Mitigate the Risks of Increasing Retirements*, Report 2015-608. CalHR has also demonstrated its commitment to supporting state agencies in their planning by developing policies and by providing training and other resources.

As of February 2017, CalHR began requiring all state agencies to draft workforce plans. CalHR assists agencies in this planning through seasonal trainings, templates, and a quarterly forum for sharing information and networking. The trainings are highly effective: 95 percent of attendees have completed or begun completing workforce plans, and 90 percent of attendees have completed or begun preparing succession plans. Overall, as of July 2019, 73 agencies have completed or are in the process of completing workforce plans, succession plans, or both. This activity represents an increase of 28 percent since 2017.

As of July 2019, 73 agencies have completed or are in the process of completing workforce plans, succession plans, or both; representing an increase of 28 percent activity since 2017.

CalHR's workforce and succession planning efforts are adequately managing the State's risk given the nature of the State's workforce. State employees leave the workforce primarily through retirement and voluntary separation. However, the annual percentage of state worker retirements since 2014 has remained low, consistently

hovering just under 4 percent. Further, the percentage of the State's workforce over 50 years of age has fallen slightly, from about 40 percent in June 2013 to about 38 percent in December 2018. Similar to retirements, voluntary separation rates in 2016 and 2017 were low, at around 3 percent annually. These rates are significantly lower than the average separation rate of about 10 percent for other state and local entities nationwide. These trends coupled with increases to retirement age requirements—from 55 to 62—under the Public Employees' Pension Reform Act of 2013 have decreased the overall risk to the State.

Agency Comments

CalHR did not provide written comments to our draft report.

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

Respectfully submitted,



ELAINE M. HOWLE, CPA
California State Auditor

January 30, 2020