DEPARTMENT OF CORRECTIONS

Its Fiscal Practices and Internal Controls Are Inadequate to Ensure Fiscal Responsibility

REPORT NUMBER 2001-108, NOVEMBER 2001

We evaluated the Department of Corrections' (department) budgeting practices, fiscal management, and contracting practices. We found the department practices in each area were inadequate to protect the best interests of the State. Specifically, we found:

Audit Highlights . . .

Our review of the California Department of Corrections' (department) fiscal practices and internal controls revealed:

- ☑ ***Spending plans, which are used to control program expenditures and to identify potential shortfalls, are inaccurate and do not align with the department's spending authority.***
- ☑ ***Excessive use of custody staff overtime and sick leave, combined with inadequate funding, is the primary cause of its budget shortfalls.***
- ☑ ***Improved contracting practices could result in hundreds of thousands of dollars per year in savings and prompt payments to contractors.***
- ☑ ***Proactive strategies for reducing costs related to legal actions are not fully implemented.***

Finding #1: Unrealistic spending plans hinder the department's ability to manage its fiscal situation effectively.

The department's spending plans, which it uses to control program expenditures and to identify potential shortfalls, do not provide an accurate base from which it can make informed fiscal decisions. In fact, we found variances as large as $168 million between its spending authority and spending plan in one year. This situation has occurred because the department failed to ensure that its spending plans correspond to its spending authority. This failure may have contributed to the departments past funding shortfalls.

To manage its fiscal operations more effectively, we recommended that the department ensure its spending plans correspond to its spending authority.

Department Action: Corrective action taken.

The department reported that it has reconciled its budget authority to its spending plan for fiscal year 2000–01. It also stated that the spending plans would be adjusted throughout the year when it receives executive orders and budget revisions that impact the department's spending authority. The Office of Financial Management will continue to ensure that the final spending plans align with the final spending authority.

Finding #2: The department needs to improve the way it communicates to the Legislature.

Because of differences between the department's spending authority and how it spends its funds, the department should prepare and present a report to the Legislature that reflects its spending plans and realistic projections for where it expects its expenditures to occur. Such a report would allow for resolution during the budget process and ultimately should result in spending authority and spending plans that realistically reflect where the department is spending its funds.

In light of its continuing budgetary challenges, the department should report the status of its financial position to the Legislature each November, February, and May.

➲ ***Department Action: None.***

The department states that it cannot comply with this recommendation due to a lack of staff resources or adequate data systems. The department also believes that the prescribed time frames for submittal of the reports is unrealistic given the current parameters for securing month-end accounting data necessary for preparing the reports. The department is currently preparing a feasibility study report related to the acquisition of an Enterprise Resource Planning Business Information System, which, if approved, will provide the department with the ability to generate more detailed expenditure reports. However, we believe the department's current data systems are adequate for preparing the suggested report.

Finding #3: The department needs to reevaluate its standard costs.

To adjust the department's spending authority and spending plans for increases and decreases in inmate and parolee populations and in the number of staff needed to guard and provide services to inmates, the department uses standard cost factors. However, we found the department did not update these standard costs as recommended by the department staff that redesigned them. Consequently, the information used to compile the standards are now over four years old and do not reflect the department's true needs.

To better match its budgeted funds to its actual expenditures, we recommended that the department periodically review and update its standard cost formulas.

Department Action: Pending.

The department contracted for an independent review to develop a new base budget methodology that will provide cost measurements (standard costs) that represent the department's true costs. Once the new methodology is developed, the department states that it will periodically update its standard costs as needed.

Finding #4: The department's fiscal monitoring activities are inadequate.

Because the department uses the inaccurate spending plan figures, discussed above, as the basis for its primary fiscal management system (monthly budget plan review), it is not using a reasonable basis for fiscal decision making. In addition, department fiscal analysts spend much of their time reviewing methods used by institutions to project expenditures instead of analyzing the problems and issues presented. Finally, even when its monthly budget plans identify problems, the department rarely takes corrective action. Until the department resolves these issues, its fiscal monitoring efforts will be futile.

To improve its fiscal management, we recommended that the department fully implement and use its new automated monthly budget plan review and ensure that it prepares and implements corrective action plans to aid in the resolution of projected spending deficiencies.

Department Action: Partial corrective action taken.

The department's automated monthly budget plan has been implemented statewide and effective November 1, 2001, the department is conducting monthly evaluations of the plans. The department also stated that it will conduct monthly fiscal briefings to the directorate and that any programs that have not submitted corrective action plans will be contacted and required to do so.

Finding #5: The department can improve its deficit analysis process.

The department asserted that there are 12 causes for its recurring budget shortfalls; however, we found that the department's conclusions as to the origins of these deficits were often lacking what we would consider sound financial analysis. Specifically, the department's analysis for 8 of its 12 asserted causes lacked a comparison of budget-to-actual expenditures and the department could not provide support for the base values used in one analysis. In addition, we found that although the department may have incurred shortfalls in particular expenditure line items, in two cases a higher level analysis of the expenditure category or program indicated that sufficient funds were available in other line items to cover the shortfall.

We reviewed four years of the department's spending plans and expenditures for five expenditure categories, and although department expenditures increased in each of the categories, we found that in all cases the amount reflected in the department's spending plan had decreased in one or more years. Our analysis indicates that the department can manipulate the shortfall in an expenditure category by decreasing the posting to its spending plan.

To improve the way it analyzes areas contributing to budgetary challenges, the department should compare year-to-date and projected expenditures to a budget that aligns with its spending authority. The department should perform this analysis in conjunction with an overall program analysis to ensure that shortfalls in one area cannot be covered with surplus from another area.

➲ ***Department Action: Partial corrective action taken.***

The department reported that it is now continuously reconciling its spending plans with its spending authority and that its monthly budget plan review provides an effective tool for monitoring the department's overall fiscal condition. However, the department did not address whether it would conduct a program analysis in conjunction with its expenditure line item reviews.

Finding #6: Eliminating excessive overtime would save the State at least $42 million per year.

In fiscal year 2000–01, the department incurred more than $176 million in overtime expenditures for custody staff—nearly double its spending authority of $89 million. Excessive overtime is primarily caused by excessive custody staff vacancies and overuse of sick leave. In fact, a department analysis of its overtime expenditures revealed that 72 percent of the overtime was avoidable, meaning that a scheduled person on regular time could have filled the need—if available. The department could reduce its budget shortfall by at least $42 million by replacing costly overtime expenditures with regular time pay when possible.

To resolve its funding shortfall for custody staff, the department should act aggressively to fill all vacant custody staff positions and continue its efforts to lower to budgeted levels its staff's use of sick leave.

➲ ***Department Action: Pending.***

The department stated that it has been aggressively pursuing enhanced recruitment policies (made possible by an increase in funding authority from the administration and the Legislature) with positive results. The number of cadets that graduated in fiscal year 1998–99 was 1,214 versus 1,830 projected for fiscal year 2001–02. The department reported that it will continue aggressive recruitment efforts. The department also reported that it is controlling sick leave usage to the extent possible under federal and state laws. The director stated that he will continue to take appropriate steps regarding the abuse of sick leave, but did not indicate what these steps would entail.

Finding #7: The department has failed to act promptly to control workers' compensation costs.

Excessive workers' compensation costs contributed approximately $28 million to the department's funding shortfall in fiscal year 2000–01. However, the department has failed to take action to control these escalating costs—further evidence of the department's failure to take action to protect the State's interests when it identifies fiscal problems.

To reduce workers' compensation costs, we recommended that the department continue to develop and implement a mitigation strategy as soon as possible.

Department Action: Pending.

The department is in the process of developing a three-year workers' compensation cost containment strategy plan. The plan includes six areas that will aid the department in controlling workers compensation costs. The six areas include a fraud program, partnering with other agencies, identifying the role of the return-to-work coordinator (RTWC), developing tools to improve case management, providing education and training to the RTWCs, and developing ways to streamline the process. The Legislature also authorized six new positions in the fiscal year 2001–02 budget for a new program to assist in combating workers' compensation fraud within the department. The department reported in November 2001 that this program is currently being implemented.

Finding #8: Changing job placement programs would increase placements and reduce costs.

The department could save over $700,000 per year and place hundreds more parolees into the work force by expanding its use of the Jobs Plus program (Jobs Plus) and eliminating its use of the Offender Employment Continuum program (Continuum). Parolee job placements through Continuum are more costly than those through Jobs Plus because of the basis used for payments. However, it is unclear why Jobs Plus places parolees into jobs at higher rates.

To maximize its use of contract funds and ensure that it does not incur unnecessary charges, we recommended that the department pay its Continuum subcontractors for each placement of a parolee, just as it does with Jobs Plus contractors. The department should also implement strategies to encourage higher job placement rates for the Continuum contractors.

We also recommended that if the department cannot improve Continuum's placement rates and reduce to a level commensurate with Jobs Plus the cost for each placement, the department should eliminate Continuum and expand Jobs Plus to accommodate those parolees whom the department would have referred to Continuum. In addition, if department staff find the Continuum workshop superior to that of Jobs Plus because it leads to lower recidivism rates, the department should consider revising its contract with Jobs Plus to include a workshop that is similar to that of Continuum.

Department Action: Pending.

The department believes it is too early to conclude that one job placement program is better than the other and is waiting for the results of two studies before making decisions on which program warrants future funding. One study is not due until approximately January 2004. In addition, the department is attempting to reduce the average cost of Continuum by increasing parolee participation, examining site locations to determine optimal placement, and will explore the feasibility of changing the reimbursement process for existing Continuum contracts.

Finding #9: The department is paying excessive indirect costs for its Jobs Plus contract.

The department paid but could not support nearly $24,000 in indirect contract costs to the Jobs Plus contract administrator. In addition, the department could have saved $150,000 if it had negotiated the current federal indirect cost rate instead of the rate in its contract with Jobs Plus. Using the federal rate is not uncommon as the department used an even lower rate in its previous contract with Jobs Plus.

To further maximize the use of contract funds without incurring unnecessary charges, we recommended that the department obtain and review cost allocation plans for all contracts and seek cost recovery for any unsupported costs. Further, we recommended that the department attempt to negotiate the indirect-cost rate that its contract administrator charges federal programs, or a lesser rate, in future contracts.

Department Action: Pending.

The department stated that it will investigate the feasibility of adopting the federal indirect cost rate in future contracts. Depending on the results of the feasibility study, the department may require a review of all cost allocation plans that exceed the guidelines developed. However, the department believes that reviewing all cost allocation plans creates a workload and staffing issue, which the department does not have the resources to address at this time. Alternatively, the department will require contractors to retain a current cost allocation plan and will review the plan and recover any unsupported charges during any audits it conducts.

Finding #10: Some of the substance abuse program's subcontractors do not receive prompt payments.

Our review of a sample of invoices revealed that some subcontractors have to wait as long as four months to receive payment. Such lengthy delays can have severe repercussions for these subcontractors, forcing some to rely on costly lines of credit to meet their financial obligations and threatening the solvency of other subcontractors. The department is contributing to the payment problems by failing to establish a mechanism for subcontractors to communicate their problems and by not enforcing contractual payment provisions.

Our recommendation to help ensure that contractors and subcontractors receive payments in a timely manner, was for the department to establish a formal complaint mechanism for contractor payment delays or other problems, and to assist in resolving identified problems.

Department Action: Pending.

The department stated that discussions with primary and second-tier providers have focused on strategies to streamline the payment process and to establish clear lines of communication, with the primary objective to alleviate cash flow problems to all levels of service providers, including third-tier subcontractors. It also responded that specific discussions may include a requirement for all second-tier contractors to include a notification to all third-tier contractors of the appropriate department address, telephone number, and contact person to be contacted if any payment problems occur. The department has also assessed the current payment flow and implemented changes to the current contracts, which allows a smoother and more efficient payment flow to all levels of service providers. Specifically, the modifications permit second-tier subcontractors to receive direct payments from the State Controller's Office, thereby eliminating the first layer in the original payment design. The department will also revise future contract language to provide contractors with department personnel and phone numbers to address program contract and payment issues that may arise.

Finding #11: Inconsistent contract monitoring does not ensure the best use of state resources.

The department's monitoring of subcontractors is inconsistent, ranging from inadequate in some cases to excessive in others. As a result, the department is not allocating its limited resources in the most efficient, effective manner to ensure the accuracy of contractor invoices and the satisfactory delivery of services.

To use its resources more efficiently and to make sure that contractors and subcontractors comply with contract provisions, we recommended that the department standardize its contract monitoring procedures. These procedures should include a requirement for its primary contractors to provide a list of all subcontractors, including their addresses and primary contacts, so that the department can identify any possible self-dealing and take appropriate action to ensure that all invoices from entities that subcontract with themselves are legitimate. We also recommended that the department establish a procedure for reviewing a sample of invoices, such as 10 percent, for all other subcontractors and establish procedures to schedule and conduct periodic site visits for all contractors and subcontractors.

Department Action: Pending.

The department reported that it will revise contract language to require that subcontractor information is included in all future contracts. It also stated that it is developing training material to provide contract-monitoring training to its major programs. The department is examining the feasibility of identifying and sampling contracts for review where problems are more likely to occur. To streamline and eliminate overlapping administrative functions for one program, the department restructured the contract to more clearly define responsibilities and implemented a revised invoice procedure that places the responsibility for the invoice review with the contract's administrative intermediary. Finally, the department plans to formalize policies and procedures for the review of documentation in support of subcontractor invoices that are reviewed by the primary contractor. However, the review will be reserved for limited cases based on department staffing levels.

Finding #12: The department overstated the benefits of a recent reorganization of its central administration program.

In an April 2001 hearing before the Joint Legislative Audit Committee, the department reported that a reorganization of the department's Central Administration Program was responsible for cost reductions of $19.6 million in fiscal year 2000–01. However, our analysis revealed that the majority of the reported savings—$13.6 million—relates to what we consider normal year-end budget activities and not to the reorganization.

We recommended that the department continue to conduct evaluations of its budget needs as part of its year-end budget activities and eliminate funding for unneeded items or positions.

Department Action: Pending.

The department stated that it will continue to evaluate program budget needs on an ongoing basis and realign funding as appropriate.

Finding #13: The department can improve its efforts to minimize legal expenses.

The department has not fully implemented all its strategies designed to reduce the occurrence and consequences of costly legal action against the department. Until it does so, it will not be able to manage legal costs as effectively as possible.

To manage potential litigation costs as effectively as possible, we recommended that legal affairs fully implement all its proposed cost-cutting strategies, fix or replace its case-tracking database to provide a stable tracking system for all settlement and judgment costs, and consider the viability of tracking all internal and external attorney costs associated with each legal case.

Department Action: Pending.

The department reported that it is taking all available steps to fully implement the recommendations.