Implementation of State Auditor's Recommendations

Audits Released in January 2002 Through December 2003

Special Report to

Senate Budget and Fiscal Review Subcommittee #2—Resources, Environmental Protection, Public Safety, and Energy

February 2004
Report No. 2004-406 S2

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February 25, 2004 2004-406 S2

The Governor of California
Members of the Legislature
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its special report for the Senate Budget and Fiscal Review Subcommittee No. 2—Resources, Environmental Protection, Public Safety, and Energy. This report summarizes the audits and investigations we issued during the previous two years that are within this subcommittee's purview. This report includes the major findings and recommendations, along with the corrective actions auditees reportedly have taken to implement our recommendations.

This information is also available in a special report that is organized by policy areas that generally correspond to the Assembly and Senate standing committees. This special policy area report includes appendices that summarize recommendations that warrant legislative consideration and monetary benefits that auditees could realize if they implemented our recommendations. This special policy area report is available on our Web site at www.bsa.ca.gov/bsa/reports/subcom2004-policy.html. Finally, we notify auditees of the release of these special reports.

Our audit efforts bring the greatest returns when the auditee acts upon our findings and recommendations. This report is one vehicle to ensure that the State's policy makers and managers are aware of the status of corrective action agencies and departments report they have taken. Further, we believe the State's budget process is a good opportunity for the Legislature to explore these issues and, to the extent necessary, reinforce the need for corrective action.

Respectfully Submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

TABLE OF CONTENTS

Senate Budget and Fiscal Review Subcommittee #2—Resources, Environmental Protection, Public Safety, and Energy

INTRODUCTION

This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2002 through December 2003, that relate to agencies and departments under the purview of the Senate Budget and Fiscal Review Subcommittee No. 2—Resources, Environmental Protection, Public Safety, and Energy. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol ➲ in the left-hand margin of the auditee action to identify areas of concern or issues that we believe an auditee has not adequately addressed.

For this report, we have relied upon periodic written responses prepared by auditees to determine whether corrective action has been taken. The Bureau of State Audits' (bureau) policy requests that auditees provide a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow-up, we request the auditee to respond at least three times subsequently: at 60 days, six months, and one year after the public release of the audit report. However, we may request an auditee provide a response beyond one year or initiate a follow-up audit if deemed necessary.

We report all instances of substantiated improper governmental activities resulting from our investigative activities to the cognizant state department for corrective action. These departments are required to report the status of their corrective actions every 30 days until all such actions are complete.

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of February 2, 2004.

To obtain copies of the complete audit and investigative reports, access the bureau's Web site at **www.bsa.ca.gov/bsa/** or contact the bureau at (916) 445-0255 or TTY (916) 445-0033.

GOVERNOR'S OFFICE OF EMERGENCY SERVICES

Investigations of Improper Activities by State Employees, March 2002 Through July 2002

ALLEGATION I2000-607 (REPORT I2002-2), NOVEMBER 2002

Governor's Office of Emergency Services' response as of September 2002[1]

Investigative Highlights . . .

The Governor's Office of Emergency Services engaged in the following improper governmental activities:

- ☑ *Allowed an employee (employee A) to continue to be paid for his commute time.*
- ☑ *Entered into an agreement with employee A's bargaining unit that the Department of Personnel Administration determined was invalid.*
- ☑ *Failed to follow its own administrative controls concerning overtime.*

In April 2000 we reported, among other things, that poor supervision and inadequate administrative controls in the fire and rescue branch of the Governor's Office of Emergency Services (OES) had enabled employees to commit various improprieties, including claiming excessive overtime and travel costs.[2] Subsequently, we received information that one employee (employee A) continued to claim excessive amounts of overtime. We investigated and substantiated this and other improprieties.

Finding #1: Despite prior knowledge, OES continued to pay employee A for his commute.

State policy prohibits state agencies from paying employees for time spent commuting from their home to the work site. Even though OES became aware that this was occurring as early as November 1998, it continued to allow employee A to claim his commute time, which contributed, in part, to the extraordinary amount of overtime he subsequently received. Specifically, during the fiscal year July 1, 1999, through June 30, 2000, employee A received approximately $100,207 in wages, of which $35,743, or 36 percent, was overtime pay. For the next fiscal year, July 1, 2000, through June 30, 2001, he was paid approximately $107,137, of which $40,523, or 38 percent, was overtime.

[1] Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2004, this is the date of the auditee's latest response.

[2] When we notified the director of OES in 2000 that we would be investigating the allegations made at that time, he informed us the CHP had begun a similar investigation at OES's request. To avoid duplicating investigative efforts, we met and coordinated with the CHP. We reported these improprieties in investigative report I2000-1.

Although much of employee A's overtime related to emergency events, nearly half was associated with nonemergency activities such as meetings or training classes. For example, of 815 hours of overtime employee A claimed in fiscal year 1999–2000, 370 hours, or approximately 45 percent, was for nonemergency events. In fiscal year 2000–01, he claimed 862 hours of overtime, of which 390 hours, or about 45 percent, pertained to nonemergency activities.

Finding #2: Employee A may not have been told to stop claiming his commute time.

Employee A and his managers have provided conflicting information regarding whether he was told to stop claiming his commute time. In July 1999, as our prior investigation drew to a close, we spoke with the former manager of the fire and rescue branch about the matter.[3] He told us that it was his understanding that employee A had been told that he no longer could claim his commute time and that he had stopped doing so. During our current investigation, employee A told us that it had always been his understanding that his home was his designated headquarters and, as a result, he claimed the time it took him to drive from his home to locations within his assigned work area. He added that to compensate for this, he sometimes did not claim all the time he spent conducting state business, such as when he worked late or responded to e-mail messages or pages on his days off. It is unclear to us why, if employee A believed this arrangement was appropriate, he felt he needed to compensate in some way for charging commute time as work hours. Regardless, we found no written evidence that OES instructed the employee that he no longer could claim his commute.

Employee A not only continued to claim his commute time, but it appears that OES never intended to prevent him from claiming this time unless it could reassign him to a work area closer to his home. In a letter dated April 7, 1999, the former manager thanked the chief of a fire district located within employee A's work area for offering OES the ability to locate one of its employees, employee A, at the fire district's headquarters. However, the former manager added, "We have reevaluated our situation and do not currently plan to relocate [employee A's] office from his current home office at this time." OES allowed the abuse to continue by declining the offer to move the employee's office from his home to a more central location within his assigned work area.

[3] This manager retired from OES effective March 30, 2001.

Finding #3: OES entered into a questionable agreement with employee A's bargaining unit.

On April 7, 1999, the same day OES formally rejected the chance to relocate employee A's office to a location within his assigned work area, OES entered into a questionable agreement with employee A's bargaining unit. Further, not only did OES enter into this questionable agreement with employee A's bargaining unit—an agreement that the current manager of the fire and rescue branch believes permitted the employee to continue to claim his commute—but it also did not provide the Department of Personnel Administration (DPA) an opportunity to review and approve the agreement as required. When we asked the appropriate DPA official to review the agreement, he questioned its appropriateness and said he considered it invalid.

Finding #4: The Fire and Rescue Branch still does not adhere to administrative controls concerning overtime.

Because the Fire and Rescue Branch (branch) failed to follow its own administrative controls concerning overtime, employees have continued to incur nonemergency overtime that lacked advance authorization. In an attempt to address the past failure of the branch to control excessive nonemergency overtime and related expenses, OES reported to us on February 10, 1999, that it had implemented an administrative system that required employees in the branch to submit in a timely manner various documents that included but were not limited to a monthly calendar of planned activities, overtime authorization and claim forms, authorization for on-call hours, and absence and time reports. OES reported that supervisors would compare each document with previously approved authorizations and individual planning documents to ensure agreement and to continuously monitor overtime use and travel expenses. However, one supervisor responsible for performing these control functions admitted that some employees under his supervision had not submitted the appropriate documents by the third working day of each month, as required. As a result, the supervisor said that there might have been instances when he was not able to review and approve planned overtime and travel incurred by employees under his supervision.

Although we did not perform an extensive review of the records of each employee in the branch, we did note several instances in which employees did not receive advance approval of nonemergency overtime. For instance, during July 1999, employee A claimed 84.5 hours of overtime, 73 of which related

to nonemergency events. However, none of the documents we obtained from the branch show that employee A received prior approval for the nonemergency overtime he claimed. In June 2000, of 99.5 hours of overtime claimed by employee A, 60.5 hours were nonemergency overtime. Again, the documents we obtained did not show that employee A obtained prior authorization to work the overtime. In June 2001, another employee, employee B, claimed 43.75 hours of overtime, all for nonemergency events. Yet none of the documents we reviewed indicated that he had received prior approval for the overtime. Given that employee A and the rest of the branch historically have incurred significant amounts of nonemergency overtime, we believe it would be prudent for OES to follow its own administrative procedures designed to monitor and control overtime and travel costs.[4]

OES Action: Corrective action taken.

OES reported that the unresolved supervisory and administrative issues associated with the branch were a result of miscommunications during changes to branch management or inadequate training, but that these issues have now been addressed. Employee A has been reassigned to a work area where he lives. OES also reported that it has established administrative controls concerning overtime authorization and that it has counseled all branch employees that nonemergency overtime will not be incurred without prior authorization.

[4] We previously reported that only 41 percent of overtime claimed by employees at the branch from November 1996 through June 1997 related directly to emergency conditions.

GOVERNOR'S OFFICE OF EMERGENCY SERVICES

Its Oversight of the State's Emergency Plans and Procedures Needs Improvement While Its Future Ability to Respond to Emergencies May Be Hampered by Aging Equipment and Funding Concerns

REPORT NUMBER 2002-113, JULY 2003

Governor's Office of Emergency Services' response as of September 2003

Audit Highlights . . .

Our review of the Governor's Office of Emergency Services' (OES) and counties' ability to coordinate and respond to multijurisdictional and multiagency emergencies revealed the following:

- ☑ *OES lacks a formal process to regularly review and update the State Emergency Plan and its related annexes.*
- ☑ *OES does not consistently perform activities needed to evaluate and improve its coordination of emergency responses under the Standardized Emergency Management System.*
- ☑ *Clarification of the roles and responsibilities of the State's Office of Homeland Security and OES would be beneficial.*
- ☑ *With aging equipment and other equipment not in place, OES's ability to task its own resources during an emergency may be limited.*

The Joint Legislative Audit Committee (committee) requested that the Bureau of State Audits (bureau) review and assess the Governor's Office of Emergency Services' (OES) policies and procedures for assessing and coordinating multijurisdictional and multiagency responses to emergencies under the Standardized Emergency Management System (SEMS) and the emergency plan. Further, the committee requested the bureau to determine if OES is maintaining the emergency plan as required by law and whether a sample of local government emergency operation centers (EOCs) are adequately prepared to respond to emergencies following SEMS. We found that the State's emergency plan and related annexes provide adequate guidance to agencies responding to multijurisdictional emergencies, but that OES lacks a formal process to regularly evaluate and update these plans. Additionally, OES is not consistently evaluating the use of SEMS by preparing statutorily required after-action reports following all declared disasters. Also, OES has had difficulty in acquiring and maintaining emergency response equipment due to what it asserts is inadequate funding. Finally, our review of six county EOCs found that they had adequate plans and training to prepare for emergencies. However, OES's recent survey of all county EOCs reveals that some counties are in need of potentially costly upgrades to improve their ability to respond to emergencies.

Finding #1: OES has not established a formal process to regularly evaluate and update the state emergency plan and related annexes.

Although we found that the State's emergency plan and related annexes adequately guide agencies to respond to emergencies, OES lacks a formal process to regularly evaluate and update these documents as necessary. OES indicates that previous emergency plan updates were made in 1959, 1984, 1989, 1998, and 2003. OES's review of the plan in 2003 was part of a federal effort to ensure that the emergency plan is current. When we asked whether OES regularly updates the emergency plan and related annexes, the director of OES's Planning and Technological Assistance Branch explained that they do not, but that they are updated when changes in state or federal laws impact emergency management, or when changes in regulations, policies, or significant procedures occur. Although OES has not established a formal process to regularly review the emergency plan and its related annexes, other states regularly update their plans so that they may incorporate lessons learned into their plans. Absent a formal and regular evaluation process for the emergency plan and its related annexes, the State's emergency plan and annexes may not reflect current practices or provide sufficient guidance during an emergency.

To ensure that the emergency plan and its related annexes are regularly evaluated and updated when necessary, we recommended that OES develop and follow formal procedures for conducting regular assessments of these plans to determine if updates are required.

OES Action: Partial corrective action taken.

OES indicates it is in the process of revising the plans review policy in the OES Policy and Procedures Manual to incorporate review and maintenance of the State's emergency plan. The revised policy will establish a formal time frame for review and progressive maintenance of the State's emergency plan based upon a review checklist, which is under development. The checklist includes planning criteria from multiple state and federal publications that focus on preparedness and response planning considerations.

Finding #2: OES has not consistently evaluated the use of the SEMS.

OES is missing important opportunities to identify and make improvements to SEMS. This is because OES fails to consistently and adequately prepare, or follow up on, the statutorily required

after-action reports following declared disasters to incorporate lessons learned during proclaimed emergencies. OES also does not follow its own policies of maintaining SEMS through regular meetings of its SEMS advisory board and technical group—two user groups that are intended to review SEMS issues and make recommendations for improvement. Since SEMS establishes the organizational framework through which multiple agencies can jointly respond to an emergency, it seems reasonable to expect OES to take a more proactive role in ensuring that this critical element of California's emergency response effort is consistently evaluated for further improvements and enhancements.

To ensure that SEMS remains a workable method to respond to emergencies, OES should more consistently evaluate its use and identify areas of weaknesses and needed improvements. Specifically, OES should do the following:

- Institute internal controls to ensure it receives after-action reports from all responding entities to an emergency, such as requiring after-action reports prior to reimbursing local agencies for response-related personnel costs. Further, OES should ensure that the reports by local governments evaluate the use of SEMS for any needed improvements and enhancements.

- Prepare after-action reports after each declared disaster that review emergency response and recovery activities.

- Develop a system that tracks weaknesses noted in the after-action reports, which unit is responsible for correcting those weaknesses, and what corrective actions were taken for each weakness.

- Reconvene the SEMS advisory board and technical group to foster more communication on the use of SEMS, and to provide OES advice and recommendations on SEMS.

OES Action: Partial corrective action taken.

OES is developing policies and procedures for development of after-action reports to consistently evaluate SEMS. The policies and procedures will address automatic assignment of responsibilities for the after-action reports, required and optional content, process for evaluating SEMS compliance, recommendations for follow-up and change, and a clear indication of those declared disasters that do not require an after-action report.

OES indicates that SEMS issues are addressed at ongoing statewide forums, such as the Statewide Emergency Planning Committee, the OES Fire and Rescue Advisory Committee/ FIRESCOPE Board of Directors, and other related meetings. Additionally, OES continues to convene the Mutual Aid Regional Advisory Committees in all six mutual aid regions where SEMS-related issues are identified and discussed. Any significant issue will be raised to OES's management for evaluation and appropriate action, including convening the SEMS advisory board and/or the technical group.

Finding #3: Data problems prevent OES from evaluating how well it coordinates resources during emergencies.

Inaccurate and missing data in its Response Information Management System (RIMS) prevents OES from evaluating how well it coordinates responses during emergencies. Because OES is not using RIMS to capture accurate mission approval times and resource arrival times, it lacks data to evaluate how well it coordinates emergency responses. Mission approval times are important because the faster OES approves a resource request, the faster resources are likely to arrive on scene. Our review of RIMS data revealed that 13 out of 27 sampled mission approvals were late, and we were unable to determine the resource approval time for two of the requests. Furthermore, our testing showed that RIMS users did not report resource arrival times for 24 out of 27 resource requests in our sample. If OES had this information, it could evaluate whether resources are arriving promptly to emergency sites while better tracking the resources tasked to emergencies.

We recommended that OES take steps to ensure that it can accurately track how long it takes to approve resource requests and pinpoint when those resources arrived at the emergency.

OES Action: Pending.

OES indicates it will convene a meeting of an internal RIMS Working Group to address these findings and assess how to incorporate our recommendations. The first meeting will be held on October 20, 2003, where the group will begin to evaluate possible RIMS upgrades, discuss SEMS forms and reports improvements, and propose mission tasking application modifications. The group will also discuss system

changes to ensure that RIMS data is accurate and consistent. Following discussions with OES in November, we learned that the October 20th meeting took place.

The group will also determine how best to utilize RIMS for the Fire and Rescue Branch and explore all available options to meet its needs. Future plans include expanding the group to local government representatives for their input, as well as surveying RIMS users for system improvement ideas.

Finding #4: OES needs to ensure key staff are properly trained.

Citing a lack of funding, OES has not conducted a needs assessment to determine the training needs for management and workers that staff state and regional centers. OES has developed an individual training plan (training plan) program; however, OES had only developed training plans for seven of the 14 state center staff we reviewed. Although the training plan can be a useful tool, because OES does not use it for all state center staff and does not provide guidance to all supervisors preparing training plans, OES cannot ensure that all state center staff receive the training they need to effectively respond to emergencies.

To ensure that state agencies—including itself—are adequately prepared to respond to emergencies within the State, OES should determine the most critical training that emergency operations center staff, at state and regional levels, need in order to fulfill their duties, and then allocate existing funding or seek the additional funding it needs to deliver the training.

OES Action: Partial corrective action taken.

OES indicates that its training policy was revised in June 2003. The policy, in part, outlines "core competencies" for all OES staff, which include principles of emergency management, SEMS (introduction and EOC functions), and RIMS. The training policy has been provided to all branch managers who have been asked to use it in the development of their staff's individual training plans.

Finding #5: Clarification of the roles and responsibilities of OHS and OES would be beneficial.

In February 2003, the governor established the Office of Homeland Security (OHS) within the Office of the Governor. Some of the responsibilities assigned to OHS by the executive

order and to the director of OES appear to have the potential to overlap. For example, under the California Emergency Services Act, the director of OES is assigned the responsibility of coordinating the emergency activities of all state agencies during a state of war emergency or other state emergency, and every state agency and officer is required to cooperate with the director in rendering assistance. However, under the executive order, OHS is assigned the responsibility of coordinating security efforts of all departments and agencies of the State and the activities of all state agencies pertaining to terrorism-related issues, and is designated as the principal point of contact for the governor. Moreover, the director of OES is required to report to the governor through OHS, but that reporting function is not limited to issues related to state security or terrorism, and thus appears to require OES to make all reports to the governor through OHS.

To ensure the State is adequately prepared to address emergencies and to avoid misunderstandings, OHS should work with the governor on how best to clarify the roles and responsibilities of OHS and OES.

OES Action: Partial corrective action taken.

OHS indicates that it continues to work with OES and the Governor's Office to clarify the roles and responsibilities, but offers no specific information about its efforts.

Finding #6: Equipment concerns may impact OES's future ability to respond to emergencies.

OES has had difficulty acquiring and maintaining emergency response and communication equipment due to what it asserts is inadequate funding. Specifically, 26 percent of OES's active fire engines have been in service for longer than the 17-year useful life that OES has adopted. OES also has no heavy urban search and rescue vehicles, which help extricate people from collapsed structures, despite a statutory mandate to obtain these vehicles. With aging equipment, and other equipment not in place, OES's ability to task its own resources during an emergency may be limited. OES has recently acquired sufficient funding to replace its aging fire engines and has taken steps to replace older fire engines, but its request for 18 heavy urban search and rescue vehicles was not funded. However, OES has not performed a current needs assessment to determine how many heavy urban search and rescue vehicles it needs in order to respond to an emergency within one hour, as required under statute.

Further, OES has not tried to establish the thermal imaging equipment-purchasing program required by law. OES's failure to take the statutorily required steps to establish this program may have denied local governments from taking advantage of an opportunity to obtain this equipment at a lower cost than they could obtain on their own. Finally, OES is facing a problem with its Operational Area Satellite Information System (OASIS), a satellite network that serves as a backup communications system, which is degrading and threatens OES's ability to coordinate with local governments should phone communications become disabled during a major emergency.

To ensure that it and local governments have the equipment to adequately respond to emergencies, OES should take the following actions:

- For its fire engine program, OES should continue with its schedule for replacing older and poor performing fire engines in the fleet.

- OES should perform a needs analysis to determine the number of heavy urban search and rescue units that are required to respond to a major earthquake. If this needs analysis concludes that additional units are required, OES should submit a budget change proposal to acquire this equipment, and it should develop a maintenance and replacement schedule for this equipment.

- OES should take the required steps to establish a thermal imaging equipment-purchasing program, including determining the interest among local governments in purchasing this equipment. However, if OES determines that it cannot identify funding sources to pay its share, OES should explore the use of the State's buying power to enter into a contract that allows local governments to purchase this equipment at a lower cost.

OES should study options to extend the life of or replace OASIS. However, if it concludes that OASIS should be replaced, OES should justify this replacement by demonstrating that maintenance costs are exorbitant and that OASIS is down for excessive periods for repair.

OES Action: Partial corrective action taken.

OES states that it has taken the following actions regarding the recommendations above:

- OES indicates that it is taking possession of 21 new engines in accordance with the three-year procurement contract that was initiated in fiscal year 2000–01. Further, OES plans to obtain an additional 21 engines over the next three years. According to OES, all of its fire engines continue to undergo annual safety inspections, as well as after each fire incident.
- OES indicates that it will update its initial needs analysis for heavy rescue units in the State by conducting a current assessment of the statewide capability. However, OES states that it is restricted from submitting budget change proposals for more heavy rescue units, but will explore funding through other sources.
- OES plans to convene a committee meeting in January 2004 to discuss the legislative mandate for thermal imaging equipment. OES will identify further corrective action following this committee meeting.
- OES indicates that it has now executed a new three-year maintenance contract for its OASIS system. The contract period covers January 2003 through December 2005. OES states that it will continue to seek options for upgrading and extending the life of OASIS through the federal grant process, partnering efforts with other state and local agencies, and the State's budget change proposal process.

TERRORISM READINESS

The Office of Homeland Security, Governor's Office of Emergency Services, and California National Guard Need to Improve Their Readiness to Address Terrorism

Audit Highlights . . .

Our review of the Governor's Office of Emergency Services' (OES) and the California National Guard's (National Guard) terrorism readiness activities revealed:

- ☑ *Both agencies have developed plans that adequately guide their response to terrorist events, but OES has not included a prevention element in the State's terrorism response plan.*
- ☑ *OES has not always identified the critical training that staff in the operations centers need to effectively complete their duties.*
- ☑ *OES does not regularly develop and administer state-level terrorism readiness exercises with other state and local agencies, as its terrorism response plan requires.*
- ☑ *Clarification of the roles and responsibilities of the State's Office of Homeland Security and OES would be beneficial.*

continued on next page

REPORT NUMBER 2002-117, JULY 2003

Office of Homeland Security, Governor's Office of Emergency Services, and California National Guard responses as of September 2003

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the terrorism readiness efforts of the Governor's Office of Emergency Services (OES) and the California National Guard (National Guard). Specifically, the audit committee asked that we review and evaluate the terrorism prevention and response plans, policies, and procedures of these agencies and determine whether the plans are periodically updated and contain sufficient guidance. It also asked that we determine whether OES and the National Guard have provided sufficient training to their staff to effectively respond to terrorism activities and assess how the training compares to best practices or other reasonable approaches. The audit committee further requested that we determine whether both agencies take advantage of all state and federal funding for terrorism readiness. Finally, the audit committee asked that we determine whether the National Guard's recruitment and retention practices and staffing levels impact its readiness to respond to terrorism activities or its ability to attract qualified personnel for terrorism readiness positions.

Finding #1: The terrorism response plan guides the State's response but does not include ways to help prevent terrorism.

Although the State Emergency Plan (emergency plan) and terrorism response plan adequately define the roles and responsibilities of numerous state and local agencies in responding to various emergencies, including terrorism, they do not address how the State could help prevent terrorist attacks from occurring. Lacking in the terrorism response plan is guidance for terrorism prevention. One reason for this deficiency may be that

- ☑ *Although the National Guard generally relies on its members' military training to respond to terrorism missions, it has not provided all of the training its staff in its Joint Operations Center needs to adequately respond to these missions.*
- ☑ *The National Guard believes it has not had sufficient funding to participate in exercises involving other state and local emergency response agencies.*

the Legislature did not envision a prevention role when it established OES in the California Emergency Services Act (act). Rather, the act sets the focus of OES as coordinating the State's response activities. However, the State needs to plan how it can help prevent terrorist events from occurring to best protect the citizens of the State against the consequences of such events. Acknowledging this void in the current terrorism response plan, the director of the Office of Homeland Security (OHS) stated that his office plans to revise the current state plan to make it more concise and include a prevention component.

To ensure that the State is adequately prepared to address terrorist threats, OHS should continue its plans to develop a state plan on terrorism that includes a prevention element

OHS Action: Corrective action taken.

OHS states that it is identifying key prevention elements that should be incorporated into the terrorism response plan.

Finding #2: OES has no formal process to periodically review and update the terrorism response plan.

OES lacks a formal process to regularly review the terrorism response plan and update it as determined necessary. Rather, OES staff state that they update the terrorism response plan when changes in statute affecting emergency management or changes occur in regulations, policies, or significant procedures. Although OES has not established a formal process to regularly review the terrorism response plan, other organizations and states we contacted do regularly update and incorporate lessons learned into their plans. Without an established process to regularly review the plan, OES cannot ensure that it remains current and adequately protects the State. Furthermore, OES would make its assessment more consistent and effective if it developed a checklist to guide its efforts in evaluating the terrorism response plan.

OHS and OES should ensure that the state plan addressing terrorism is reviewed on a regular basis and updated as determined necessary to ensure that it adequately addresses current threats and benefits from the lessons learned in actual terrorist readiness events occurring both in California and nationwide. Additionally, they should develop a checklist to guide periodic evaluations of the state plan addressing terrorism to ensure that such assessments are consistent and effective.

OES Action: Corrective action taken.

OES states that it is developing formal procedures to review, assess, and update the emergency plan and its related annexes, including the terrorism response plan. OES also states that it is developing a checklist to guide its reviews.

Finding #3: OES has not identified the training needs for all of its staff.

OES has not conducted a needs assessment to determine the training requirements for all personnel in its state and regional operations centers. Although OES does develop individual training plans for some of its staff, which identify an individual employee's career goals and objectives, it does not prepare them for all staff working in state and regional operations centers. Furthermore, OES does not provide guidance to all supervisors preparing the training plans to ensure that they include training related to core competencies. Core competencies are the key skills employees need to possess to perform their assigned duties.

To ensure that state agencies, including OES, are adequately prepared to respond to terrorist events occurring within the State, OES should identify the most critical training required by staff at state and regional operational centers and then allocate existing funding or seek additional funding it needs to deliver the training.

OES Action: Corrective action taken.

OES states that it has identified the core competencies for all OES staff and has developed a training policy to guide managers as they develop training plans for OES staff.

Finding #4: OES has not conducted state-level terrorism readiness exercises as called for in its terrorism response plan.

With the exception of federally or state mandated exercises associated with nuclear power plants and hospitals, the State does not presently have an established program to provide exercises to ensure that state agencies are prepared to respond to terrorist events. According to OES, it has not regularly developed and administered terrorism readiness exercises because it is not funded to do so. However, it has not requested state funding to conduct the exercises. OES has participated in terrorism readiness exercises when other agencies have held them, and staff have received training through activation experiences.

However, these activities would not necessarily test and enhance the capabilities of state agencies, local governments, and related entities to prepare for, respond to, and recover from terrorist events as called for in the terrorism response plan. OHS has recently decided that the California National Guard should be responsible for coordinating state-level exercises, awarding $1.6 million in federal funds to them. Because of the unique role that OES plays in coordinating emergencies, it will be important for OES to work with the National Guard to establish an effective exercise program.

To ensure that state agencies, including OES, are adequately prepared to respond to terrorist events occurring within the State, OES should assist the National Guard in providing state-level terrorism readiness exercises.

OES Action: Corrective action taken.

OES states that it is developing a functional exercise for the state and regional operations centers. It also states that it will continue to work with the National Guard in developing terrorism readiness exercises.

Finding #5: The effect of budget cuts are uncertain.

An OES analysis stated that budget cuts it is required to sustain due to the current state budget crisis will severely hinder its ability to fulfill its overall mission, including terrorism readiness. However, since February 2003, OES is to report to the Governor's Office through the OHS director, and the OHS director told us he believes that OES can meet its statutory mission despite budget cuts incurred as of June 2003. To optimize its efficiency, the OHS director intends to assess the OES organization to identify more efficient ways for OES to fulfill its statutory responsibilities, focusing its resources on mission-related activities.

To ensure that the State is adequately prepared to address terrorist threats, OHS should continue its plans to thoroughly assess OES functions to determine how it can optimize its efficiency.

OHS Action: Pending.

OHS states that it continues to assess OES functions to evaluate how best to address the budget cuts and that once the 2004–05 budget is finalized, it will be better able to address this finding.

Finding #6: Clarification of the roles and responsibilities of OHS and OES would be beneficial.

The authority provided to OES under the act and the authority provided to OHS by the governor's February 2003 executive order appear to have the potential to overlap. Further, the directors of the two offices appear to have differing views on their roles and responsibilities. A lack of clarity in their respective roles and responsibilities could adversely affect the State's ability to respond to emergencies, such as a terrorist event.

To ensure that the State is adequately prepared to address terrorist threats, OHS should work with the governor on how best to clarify the roles and responsibilities of OHS and OES.

OHS Action: Pending.

OHS states that it is working with OES and the Governor's Office to clarify the roles and responsibilities of the two offices.

Finding #7: Joint Operations Center staff have not yet completed all the training they need to effectively coordinate missions.

The Joint Operations Center is responsible for receiving state missions from OES and developing and overseeing the National Guard's response to requests for its services. In June 2002, the Joint Operations Center identified training it believes its staff need to adequately respond to state emergencies. However, 32 of the 38 members required to take specific courses had received less than half the designated training. According to the National Guard, lack of funding and limited availability of classes have hindered its ability to train its Joint Operations Center staff in the identified areas. Without proper training, the ability of the National Guard to respond promptly and effectively to state missions may deteriorate.

To ensure that its members are adequately trained to respond to terrorism missions, the National Guard should determine the most critical training its Joint Operations Center staff need to fulfill their duties and then allocate existing funding or seek the needed funding to provide the training, documenting why it is needed.

National Guard Action: Corrective action taken.

The National Guard states that it has developed a plan that identifies the training needed by the various members of the Joint Operations Center. The National Guard adds that it has not received any additional funding to provide training to members of the Joint Operations Center.

Finding #8: The Army Guard Division does not provide required terrorism awareness training to its members.

The National Guard's Army Guard Division does not provide terrorism awareness training required by U.S. Army regulations as part of its terrorism readiness force protection (force protection) program. According to the commanders of the Army Guard units we visited, the reason they have not fully implemented the terrorism awareness training is that they have not received the guidance to implement it. Further, although the regulation provides that one way the units can offer the required training is through an approved web-based course, the director of the Joint Operations Center stated that his office had been unaware of such a course until recently. However, while visiting an Air Guard unit in April 2003, we discovered that it had been using a Web-based course to fulfill the requirement for terrorism awareness training since June 2002. Therefore, despite its responsibility for implementing the force protection program in both the Air Guard and Army Guard divisions, the Joint Operations Center was unaware of the practices of the Air Guard Division that could have benefited the Army Guard Division. Had the Joint Operations Center been more aware of the training being utilized in the Air Guard Division, it could have identified this best practice and shared it with the Army Guard Division.

The National Guard should develop guidance for its Army Guard Division to implement its terrorism readiness force protection program. Additionally, it should ensure that its Joint Staff Division, including the Joint Operations Center, share best practices between its Air Guard and Army Guard divisions.

National Guard Action: Partial corrective action taken.

The National Guard states that the Army Guard Division is developing a regulation to implement its terrorism readiness force protection program, commenting that it should be fully implemented by December 2004. Additionally, the National Guard states that the Chiefs of Staff for the Army, Air, and Joint Staff divisions meet each week and include a discussion of best practices among the divisions.

Finding #9: The National Guard would benefit from increased state-level terrorism exercises

The National Guard believes that it has not had sufficient opportunities to participate in exercises with other state and local emergency response agencies. In June 2003, OHS advised us that it has now allocated $1.6 million in federal funding to the National Guard to coordinate terrorism readiness exercises that include both state agencies and rural jurisdictions. Therefore, the National Guard should soon be able to participate in terrorism readiness exercises with other state and local emergency response agencies.

The National Guard should use the recently awarded funds from OHS to identify the type and frequency of state-level exercises responding to terrorist events that the State needs to be adequately prepared. The National Guard should then provide the exercises it has identified.

National Guard Action: Partial corrective action taken.

The National Guard states that it has formed an exercise management team consisting of staff from the National Guard and other state and local agencies that have first responder responsibilities. With current grant funding, the National Guard plans to coordinate four regional and one statewide exercise by October 2004.

CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY

Insufficient Data Exists on the Number of Abandoned, Idled, or Underused Contaminated Properties, and Liability Concerns and Funding Constraints Can Impede Their Cleanup and Redevelopment

Audit Highlights . . .

Our review of the entities under the California Environmental Protection Agency (Cal/EPA) that oversee the cleanup of contaminated sites, the Department of Toxic Substances Control (Toxics) and the State Water Resources Control Board (State Water Board), found the following:

- ☑ *State law does not require Toxics or the State Water Board to capture information on brownfields, such as the number of sites and their potential reuses.*
- ☑ *Toxics anticipates needing between $124 million and $146 million for the remediation of 45 existing orphan sites and $2.4 million in fiscal year 2003–04 for orphan shares.*
- ☑ *The State Water Board's unaudited data indicate that it has seven orphan sites to which it has committed $1.4 million in state resources for cleanup.*

continued on next page

REPORT NUMBER 2002-121, JULY 2003

California Environmental Protection Agency, the Department of Toxic Substances Control, and the State Water Resources Control Board combined response as of October 2003

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of the California Environmental Protection Agency (Cal/EPA) and its entities involved in the cleanup of properties contaminated by hazardous material and waste, the Department of Toxic Substances Control (Toxics) and the State Water Resources Control Board (State Water Board). We were asked to provide information on how many orphan sites and sites with orphan shares exist in the State, as well as how much funding is needed and how much is directly available to clean up those sites.

Finding #1: California lacks a comprehensive inventory of brownfields.

California does not have a uniform definition for brownfields. Further, state law does not require Toxics or the State Water Board to maintain databases to capture information on brownfields, such as the number of sites and their potential reuse. On May 30, 2003, Toxics did submit an application to the United States Environmental Protection Agency (U.S. EPA) to receive a state response grant. Toxics intends to use a portion of the grant to work with the State Water Board and the regional water quality control boards (regional water boards) to maintain and display accurate geographical information on brownfield sites and other properties that pose environmental concerns.

☑ *The reuse of brownfields faces challenges, such as the liability provisions the federal Superfund law imposes and limited funding opportunities.*

Toxics and the State Water Board have yet to apply for certain federal grants available to assist with the State's assessment and cleanup costs for certain sites, such as mine-scarred lands.

We recommended that if Toxics does not receive funding from the U.S. EPA, Cal/EPA should seek guidance from the Legislature to determine if it desires a database to track the State's efforts to promote the reuse of properties with contamination. If the Legislature approves the development or upgrade of a statewide database that includes relevant data to identify brownfields sites and their planned and actual uses, Cal/EPA should establish a uniform brownfield definition to ensure consistency.

Cal/EPA Action: Partial corrective action taken.

Cal/EPA told us that Toxics was awarded funds from the U.S. EPA under the Small Business Liability Relief and Brownfields Revitalization Act. In conjunction with the award of these funds, Toxics and the State Water Board plan to continue efforts to operate and enhance their site information databases. The grant also calls for a survey and inventory of brownfields in the State. To accomplish this task, Cal/EPA will describe or define the types of properties to be included in this inventory.

Finding #2: Existing databases do not provide a comprehensive reporting of orphan sites and sites with orphan shares.

Toxics maintains a database to track the number of contaminated sites in the State. Although this database currently reports the number of orphan sites under its jurisdiction, the database is not able to track the number of sites with orphan shares. Additionally, due to incomplete data relating to responsible parties in the State Water Board's database, we were unable to identify the number of orphan sites under its jurisdiction. The State Water Board told us that orphan shares do not exist since the nine regional water boards apportion liability for cleanup using a strict application of joint and several liability. Under a strict application of joint and several liability there are no orphan shares because even though some share of the cleanup costs is not attributable to a responsible party, each must assume full responsibility for those costs.

We recommended that to obtain a comprehensive listing of the number of orphan sites and sites with orphan shares, the Legislature should consider requiring Cal/EPA and its entities to capture necessary data in their existing or new databases.

Legislative Action: None.

We are unaware of any legislative action implementing this recommendation.

Finding #3: Toxics and the State Water Board have yet to apply for all available federal grants.

The Small Business Liability Relief and Brownfields Revitalization Act (revitalization act) provides grants and loans to states, local governments, and other eligible participants to inventory, characterize, assess, conduct planning, and remediate brownfields. However, Toxics and the State Water Board have not applied for all available monies under the revitalization act to assist with the State's assessment and cleanup costs for certain sites.

We recommended that to reduce the State's brownfield assessment and cleanup costs, Cal/EPA should ensure that Toxics and the State Water Board apply for all available funding under the revitalization act.

Cal/EPA Action: Pending.

Cal/EPA stated that the U.S. EPA recently announced six workshops it plans to conduct to assist those interested in applying for grants under the revitalization act. Staff from Cal/EPA, Toxics, and the State Water Board plan to attend these workshops and will consider applying for these grant funds. Cal/EPA stated that the decision would depend upon a variety of factors, including the costs of preparing an application, costs associated with administering the grant funds, and limitations on the use of the funds.

WATER QUALITY CONTROL BOARDS

Could Improve Their Administration of Water Quality Improvement Projects Funded by Enforcement Actions

Audit Highlights . . .

Our review of the State Water Resources Control Board's (state board) and Regional Water Quality Control Boards' (regional boards) collection of fines and subsequent expenditure of those funds under the Porter-Cologne Water Quality Control Act (State water quality act) revealed the following:

- ☑ ***As allowed by law, there is no correlation between the amount of fines collected by a given regional board and the amount the regional board receives from the state board for water quality projects.***
- ☑ ***From fiscal years 1998–99 through 2002–03, the regional boards collected about $26 million in fines and the state board committed $24.9 million for water quality projects throughout the State.***
- ☑ ***The state board received almost $21 million from a legal settlement between the State and Atlantic Richfield Company and Prestige Stations, Inc., and shortly after committed $19.2 million of those funds for water quality projects throughout the State.***

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REPORT NUMBER 2003-102, DECEMBER 2003

California Environmental Protection Agency response as of December 2003

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to provide information to the Legislature and others to clarify how money designated to improve the State's water quality is distributed throughout the State. Specifically, the audit committee wanted the bureau to provide information related to the State Water Resources Control Board (state board) and a sample of Regional Water Quality Control Boards (regional boards), including how they assess and collect fines, whether they spend the fines in accordance with the Porter-Cologne Water Quality Control Act (State water quality act), and whether they spend the money they collect in or near the areas from which they collect it. The state board reports to the California Environmental Protection Agency (Cal EPA), which was created in 1991. The audit committee also asked us to identify any new funds available in the state board's operating budget and examine the ways those funds have been used. Additionally, the audit committee wanted to know the number and amount of fines the regional boards collected, the public or private entities or individuals who violate the State water quality act (polluters) most commonly, and the changes in the amount of fines assessed and collected over the last five years.

As allowed by law, there is no correlation between the amount of the fines collected by a given regional board and the amount the regional board receives from the state board. When allocating funds to regional boards, the state board attempts to determine how best to use available funds to meet the State's most urgent water quality needs. It appears reasonable that the state board would base its fund commitments not on where fines are generated but what represents the highest and best use

☑ *Despite appearing to focus on the main goal of ensuring that public and private entities comply with the State water quality act, regional boards sometimes fail to follow through on enforcement actions.*

of those funds. From fiscal years 1998–99 through 2002–03, the regional boards collected about $26 million in Administrative Civil Liabilities (ACL) and either spent or committed to spend $24.9 million in water quality improvement projects.

Finding #1: Regional boards can retain some benefits from their enforcement actions by approving supplemental environmental projects.

Although the regional boards do not keep the money associated with the ACLs they impose locally, they can recover at least a portion of the money or otherwise retain the benefits of their enforcement actions. First, a regional board can endorse a water quality improvement project within its region and forward it for approval to the state board, which then can allocate funds to projects it considers worthy. However, not all regional boards take advantage of this option, and they may miss opportunities to realize some benefits from their enforcement actions.

Second, regional boards might benefit from their enforcement actions, in accordance with state board procedures, by seeking partial reimbursement for staff costs they incurred in enforcing the State water quality act. However, over the last five fiscal years, only five of the nine regional boards used this option to submit a total of roughly $670,000 in claims. Also, the state board could do a better job of clearly communicating how and when regional boards may submit claims and how they can use those funds once they receive reimbursement.

Third, a regional board can retain the benefits of some of the ACLs it assesses within its region by allowing a polluter to perform or fund a supplemental environmental project (SEP) in lieu of paying a portion of an ACL. Of the four regional boards we visited, one retained benefits in lieu of almost $3.5 million and another retained benefits in lieu of more than $2.2 million of the ACLs they assessed in their respective regions. The four regions we visited retained more than $6.5 million total for SEPs.

We recommended the state board encourage and assist the regional boards in taking the following steps to ensure that the regional boards receive all the funding they are entitled to under the State water quality act:

- Identify any needed water quality improvement projects in their regions and submit the appropriate funding requests to the state board.

- Collect and compile staff costs associated with enforcing the State water quality act and submit periodic claims for these costs from the account, as the State water quality act allows.

- Evaluate strategies that other regional boards use to maximize water improvement activities in their respective regions.

We also recommended the state board take steps to communicate the intent of the practice to reimburse regional boards for staff costs and the proper way to claim and use such funds to ensure that regional boards are aware of and understand how to use and subsequently spend those funds.

State Board Action: None.

Cal EPA stated that the state board would attempt to implement the recommendations.

Finding #2: Regional boards do not always ensure that polluters complete supplemental environmental projects or pay fines.

Despite appearing to focus on the main goal of ensuring that public and private entities comply with the State water quality act, regional boards sometimes fail to follow through on enforcement actions. For example, the Santa Ana and San Francisco Bay regional boards often approved SEPs for their enforcement actions but did not always ensure that the SEPs were completed. Further, all four regional boards we visited had, as state board policy allowed, suspended portions of or entire ACLs for polluters that agreed to clean up the pollution or to stop violations. However, the San Francisco Bay regional board did not always follow up to determine that polluters either came into compliance with the State water quality act in accordance with the ACL suspension agreements or paid the ACLs.

Additionally, although all the regional boards appear to collect the mandatory minimum penalties (MMPs) that they initially assessed against polluters, the San Francisco Bay and Santa Ana regional boards could assess fines more promptly when polluters continue to commit violations subject to MMPs. Regional boards that do not assess and collect fines appropriately and ensure completion of SEPs limit their ability to protect the public

health and the environment and do not ensure that violators of the State water quality act do not gain a competitive advantage over those that comply with it.

We recommended the state board require the regional boards to monitor and report on the progress and completion of these projects to ensure that the state water system receives the maximum benefit from SEPs the regional boards approve.

We also recommended the state board require the regional boards to promptly issue and collect all ACLs to ensure that the regional boards effectively use enforcement actions to discourage violations of the State water quality act.

State Board Action. None.

Cal EPA stated that the state board would attempt to implement the recommendations.

Finding #3: Because the state board does not always obtain adequate information on all water quality project proposals, it cannot ensure that it funds the most meritorious projects.

The state board's Division of Financial Assistance (division) does not consistently obtain written information regarding proposed water quality improvement projects before submitting them to the state board for review. One reason it has not consistently obtained the information is inadequate direction from the state board. Specifically, we found that in fiscal year 2002–03, for 20 water quality projects costing $17.9 million (64 percent of the $27.9 million funded that required state board approval), although the division followed procedures it has informally established for reviewing water quality projects, it did not follow these procedures in two cases, failing to obtain documentation on two projects worth a total of $10 million from funds the state board received from a legal settlement. By not gathering all the necessary written information, it is not clear whether the division analyzed the merits of the two projects before submitting them for the state board to consider along with other water quality projects; thus, the state board could not make a fully informed decision regarding which water quality projects were the best use of funds. One factor limiting the division's ability to evaluate and analyze requests for water quality projects is that the state board has not formally adopted a policy to guide the division in fulfilling this responsibility. Instead, the

division has its own set of informal procedures that, lacking the authority of the state board behind them, the division is under no obligation to follow.

We recommended the members of the state board establish and approve a policy to guide division staff in processing project requests to ensure that division staff consistently review funding requests for water quality improvement projects. Further, to ensure that the state board has the information necessary to decide which of these water quality projects to fund, the division should follow the established policy in all instances.

State Board Action. None.

Cal EPA stated that the state board would attempt to implement the recommendations.

DISABLED VETERAN BUSINESS ENTERPRISE PROGRAM

Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success

Audit Highlights . . .

Our review of the Disabled Veteran Business Enterprise (DVBE) program found that:

- ☑ *Many awarding departments do not report their DVBE participation levels; of those that do report, most do not meet the 3 percent participation goal.*
- ☑ *The reasonableness of the 3 percent goal itself is not clear.*
- ☑ *Outreach to potential DVBEs should be more aggressive.*

Other factors that contribute to the State's failure to meet the DVBE goal are:

- ☑ *The program's overly flexible legal structure and limited clarifying regulations.*
- ☑ *The frequency with which certain departments exercise their discretion to exempt contracts from DVBE participation.*
- ☑ *Lack of effective evaluation of bidders' good-faith efforts and monitoring of contractors' compliance with contract DVBE requirements.*

REPORT NUMBER 2001-127, JULY 2002

Audit responses as of July 2003 and October 2003[1]

The Joint Legislative Audit Committee requested that we determine the extent to which departments that award contracts (awarding departments) are meeting the 3 percent Disabled Veteran Business Enterprise Program (DVBE) participation goal and to identify statutory and procedural mechanisms that could assist in overcoming any barriers to fulfilling this goal. We found that many awarding departments do not report DVBE participation as required under law, and even fewer departments actually meet the goal. Specifically, we found:

Finding #1: Awarding departments' DVBE participation statistics are not always accurate, and the methodologies they employ are at times flawed.

State law requires each awarding department to report to the governor, Legislature, the Department of General Services (General Services), and the Department of Veterans Affairs (Veterans Affairs) by January 1 each year on the level of participation by DVBEs in state contracting. General Services then issues a summary report.

Our own review showed that some awarding departments did not report DVBE statistics and others could not always provide supporting documentation for the DVBE statistics they reported. For example, for fiscal year 2000–01, the Department

[1] Business, Transportation and Housing; State and Consumer Services; and Youth and Adult Correctional agencies and Departments of General Services, Transportation, and Veterans Affairs responses as of July 2003. Departments of Fish and Game and Health Services and Health and Human Services Agency responses as of October 2003.

of Fish and Game (Fish and Game) reported $12.1 million in DVBE participation but could identify only $431,000 in specific contracts, or less than 3.6 percent of the total. In addition, the Department of Health Services (Health Services) could not provide any summarized documentation for the numbers it reported. Health Services asserted that it had documentation in individual contract files to support its figures, but indicated it would be too time intensive to tally the information for our review.

Additional problems with the accuracy of DVBE participation information exist. The reporting methodology General Services established is contrary to statutory requirements. According to statute, the 3 percent DVBE participation goal applies to the overall dollar amount expended each year by the awarding department. However, under current reporting regulations issued by General Services, awarding departments must report the amount winning bidders "claim" they will pay to DVBEs under the contract. In its clarifying instructions, General Services has asked awarding departments to report the amounts "awarded" in contracts, rather than amounts actually paid to DVBEs.

To ensure DVBE statistics are accurate and meaningful, we recommended General Services require awarding departments to report actual participation and maintain appropriate documentation of statistics, continue its periodic audits of these figures for accuracy, and, if the audits reveal a pattern of inconsistencies or inaccuracies, address the causes in its reporting instructions.

General Services' Action: Partial corrective action taken.

General Services has interpreted the statutes governing DVBE reporting to provide participation statistics to be reported based on the value of contracts awarded instead of dollars actually expended. According to General Services, this is the same methodology used in the small business participation report (California Government Code, Section 14840). General Services believes it is important to use consistent reporting standards to allow for program comparisons. Since its six-month response, based on the concerns raised by our office, General Services has revisited the issue and concluded that its own interpretation of the DVBE reporting requirements is reasonable and appropriate. We disagree with General Services' interpretation of the DVBE reporting requirements. As we state on page 18 of the audit report, departmental reporting of actual payments [to DVBEs] provides more useful information because it focuses on the realized benefit to DVBEs.

As to the issue of requiring departments to maintain documentation of participation statistics, to reemphasize this administrative control procedure, General Services indicates it has added an instruction to the new participation report form that addresses the necessity of maintaining supporting documentation. Departments used this new form in reporting fiscal year 2001–02 cumulative participation statistics. General Services is also continuing to include the audit of the DVBE reporting process within its comprehensive external compliance audit program performed of other state agencies. It indicates it uses the results of these audits to identify areas for possible improvement within the reporting process.

Finding #2: Not all state agencies have finalized and implemented their plans to monitor their departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, require a DVBE improvement plan.

In June 2001, the governor issued executive order D-43-01, which requires all state agency secretaries to review the DVBE participation levels achieved by the awarding departments within their agencies. Further, the executive order requires each secretary to require awarding departments to develop an improvement plan if the 3 percent goal is not achieved or the data is not reported. Three of five state agencies responding to our survey indicated that they were still developing procedures to monitor the DVBE participation levels of their subordinate awarding departments.

We recommended those state agencies that have not already done so should finalize and implement their plans to monitor awarding departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, monitor their efforts to improve DVBE participation.

Agency Action: Partial corrective action taken.

On June 28, 2002, the governor directed that all state departments and agencies submit monthly reports to the State and Consumer Services Agency regarding DVBE participation. Based on the reporting forms developed by the State and Consumer Services Agency, state departments and agencies are required to report total contracting dollars,

dollars paid to DVBEs, and DVBE participation percentages. In addition, departments that have not met the 3 percent DVBE participation goal are required to explain why.

Each of the following state agencies indicates the development of plans to monitor awarding departments' reporting of DVBE statistics: State and Consumer Services Agency; Business, Transportation and Housing Agency; Health and Human Services Agency; and the Youth and Adult Correctional Agency. The Resources Agency did not provide a one-year update on its efforts to implement this recommendation. Some agencies reported increases in DVBE participation during the fiscal year 2001–02. In particular, the State and Consumer Services Agency reported a DVBE participation rate of 3.3 percent in 2002, which is an increase from 1.5 percent in the prior year. Further, the Business, Transportation and Housing Agency similarly reported an increase in DVBE participation, indicating 3.7 percent participation during the fiscal year 2001–02.

Finding #3: The State does not know how many DVBEs can be certified and the extent to which they can provide needed goods and services to the State. As a result, the reasonableness of the 3 percent goal is uncertain.

Even though the law establishes a 3 percent participation goal for every awarding department, our review did not find sufficient evidence to support the assumption that this is an equitable share of contracts for DVBEs. When the DVBE legislation was being drafted in 1989, several awarding departments opposed the bill on the grounds that the 3 percent goal was unrealistic.

The awarding departments' concern about enough DVBEs to justify the 3 percent goal seems to have been valid. As of May 2002, General Services had only 797 DVBEs certified and available for contracting. The services these DVBEs offered and their geographical distribution did not always match the State's needs. All five agencies responding to our survey and many awarding departments' improvement plans identified a limited pool of DVBEs as one of the impediments to meeting the 3 percent DVBE participation goal.

To determine if the 3 percent DVBE goal is reasonable, the Legislature may wish to consider requiring either General Services or Veterans Affairs to commission a study on the

potential number of DVBE-eligible firms in the State, the services they provide, and their geographic distribution, and compare this information to the State's contracting needs.

Based on the results of this study, the Legislature may wish to consider doing the following:

- Modify the current DVBE participation goal.
- Allow General Services to negotiate department-specific goals based on individual contracting needs and the ability of the current or potential DVBE pool to satisfy those needs.

Legislative Action: None.

We have found no indication that any study on DVBE-eligible firms has been commissioned. Further, the statutory requirement for the DVBE participation rate remains at 3 percent, while the reasonableness of this goal remains unclear.

Veterans Affairs' Action: None.

According to Veterans Affairs' September 2002 response to this recommendation, it appears that the department was intending to commission a study on the number of potentially DVBE-eligible firms in the State. However, the department's July 2003 update does not specifically address this recommendation.

Finding #4: General Services is not sufficiently aggressive or focused in its outreach and promotional efforts for the DVBE program.

As the administering agency for the DVBE program, General Services has been responsible for certifying eligible businesses as DVBEs and conducting promotional and outreach efforts to increase the number of certified DVBE firms.

It is unclear to what extent General Services' outreach activities target disabled veterans' groups. General Services was also unable to readily quantify its outreach activities. The information it ultimately provided was based on old personal calendars and planners. We also could not evaluate the effectiveness of these outreach activities since General Services only selectively monitors the results.

To ensure the DVBE program is promoted to the fullest extent possible, we recommended General Services aggressively explore outreach opportunities with the U.S. Department of Veterans Affairs and organizations such as the American Legion, Disabled American Veterans, and Veterans of Foreign Wars. In particular, General Services should cultivate a clear working relationship with county veteran service officers. It should also maintain complete records of its outreach and set up a system to track effectiveness. For example, General Services could consistently survey newly certified DVBEs to determine how they heard about the program and what convinced them to apply for certification. Finally, General Services and Veterans Affairs should continue to work to develop their joint plan for improving the DVBE program, finalizing and implementing it as soon as possible.

General Services' and Veterans Affairs' Action: Partial corrective action taken.

On June 28, 2002, the governor directed the implementation of a more intensive DVBE outreach effort, with the staff dedicated to that effort moved from General Services to Veterans Affairs. According to General Services, on August 1, 2002, the two DGS staff members performing the outreach function physically transferred to Veterans Affairs.

According to the July 2003 response from Veterans Affairs, it has completed the CDVA Disabled Veterans Business Enterprise Outreach Program Plan, which became effective April 1, 2003. The plan indicates that Veterans Affairs will introduce General Services "outreach team members" to veteran organizations' leadership and local county veteran services officers. However, Veterans Affairs also indicated that in May 2003, the two employees working on DVBE outreach, formerly from General Services, returned to that department. The plan also indicates that Veterans Affairs will establish working relationships with veteran service representatives and local county veteran service organizations.

Finding #5: Some awarding departments exempt a significant number of contracts, potentially limiting their ability to maximize DVBE participation rates.

Under statute, the DVBE participation goal applies to an awarding departments' overall expenditures in a given year. Therefore, awarding departments have the discretion to apply DVBE participation requirements on a contract-by-contract basis.

The frequency with which certain awarding departments exempt contracts from DVBE requirements is significant. Further, some of these awarding departments are not tracking the value of the contracts they exempt or the required compensating increase in participation goals for their remaining non-exempt contracts. For fiscal year 2000–01, two of the five awarding departments we reviewed, Health Services and Caltrans, did not compensate for these exemptions with increased participation on other contracts, and subsequently reported they did not meet the participation goal. According to our calculations, Health Services exempted 48 percent of DVBE-eligible contract dollars it reported in fiscal year 2000–01, which means it would have had to average almost 6 percent on all remaining eligible contracts to meet the goal. Similarly, General Services' procurement division estimated that it exempted over 50 percent of its contracts during fiscal year 2000–01.

Awarding departments offer varying reasons for their exemption decisions. Some departments we reviewed exempt all contracts with certain characteristics, and the reasonableness of these blanket decisions may not be clear. For example, at least one unit within four of the five departments we reviewed has indicated it exempts all contracts it believes do not offer a subcontracting opportunity for DVBEs. However, this practice may significantly reduce a department's chances for obtaining more DVBE participation.

To maximize DVBE participation, we recommended awarding departments attempt to use DVBEs as prime contractors instead of viewing them only as subcontractors. Further, the awarding departments should periodically examine the basis for their assumptions behind blanket exemptions for whole categories of contracts to ensure the exemptions are justified.

General Services', Caltrans', Health Services', and Fish and Game's Action: Partial corrective action taken.

General Services indicates it has policies and practices that actively encourage the use of DVBEs as prime contractors. Further, General Services has asserted that its chief deputy director stressed to General Services staff that all contracts include DVBE participation unless specifically exempted. Caltrans indicates that its DVBE exemption requests are researched to verify that no certified DVBEs are available in the particular geographic area specified to perform the work. Caltrans also indicates that it mails DVBE solicitation

materials to contractors who are on a special list of DVBEs and who provide services in the geographical area. Health Services similarly reported that it now reviews each DVBE exemption request by requiring its programs to explain why DVBE participation is not viable or possible. Health Services also requires that General Services' Web site be verified to ensure no DVBEs are available to perform likely subcontract services in the service location. Fish and Game asserts it does not have a blanket exemption by category type. However, it indicates that it does exempt contracts under $10,000 from DVBE participation requirements. Fish and Game has determined that requiring bidders to undergo a good-faith effort to find and use a DVBE under these circumstances is not cost-effective. Fish and Game also indicates that if the lowest bidder on a contract is a DVBE, it awards the contract to the DVBE acting as a prime contractor.

Finding #6: Awarding departments do not consistently scrutinize and evaluate good-faith effort documentation or ensure that DVBEs are actually being used as called for in contracts.

The effectiveness of the implementation of the good-faith effort may be diminished by the lack of consistent or meaningful standards for awarding departments to follow when evaluating bidders' documentation of such efforts. Although statute requires General Services to adopt standards, it has not issued much direction to awarding departments on how to evaluate a bidder's good-faith effort. The State Contracting Manual offers appropriate suggestions for procedures in assessing good-faith effort, but the suggestions are not binding. There is also no clear requirement in statute requiring awarding departments to monitor actual DVBE participation to ensure the contractor is complying with the contract's DVBE requirements.

A common result of this lack of direction is the cursory evaluation of a bidder's good-faith effort documentation and inconsistent monitoring of actual DVBE usage. For example, Health Services does not instruct staff to independently verify bidders' statements that they solicited DVBEs to participate as subcontractors. Before February 2002, Health Services also lacked policy to monitor actual DVBE participation. Caltrans also does not follow up to ensure the DVBEs that the bidder claimed to have solicited were actually contacted. Although

Caltrans' procurement unit did have a policy to monitor actual DVBE participation to ensure contract compliance, we saw no monitoring consistent with this policy in a sample of their contract files.

To ensure that prime contractors make a genuine good-faith effort to find a DVBE, we recommended the Legislature consider requiring awarding departments to follow General Services' policies. General Services should issue regulations on what documentation the awarding departments should require and how they should evaluate that documentation. These standards should include steps that ensure the documentation submitted is accurate. Similarly, General Services should issue regulations on what steps departments should take to ensure contractors meet DVBE program requirements. These steps might include requiring awarding departments to monitor vendor invoices that detail DVBE participation or requiring the vendor and DVBE to submit a joint DVBE utilization report.

Legislative Action: None.

We found no indication that the Legislature has required awarding departments to follow General Services' policies regarding the evaluation of bidders' good-faith effort documentation.

General Services' Action: Partial corrective action taken.

Effective April 1, 2003, the procurement division of General Services revised its solicitation instructions and forms to require bidders to provide additional information and documentation on their compliance with DVBE program requirements. These new bidder instructions are available on General Services' Web site and are available for use by other state agencies. Further, General Services states that it has begun the process of reviewing DVBE program regulations to identify areas of improvement.

Finding #7: The efficiency and effectiveness of the DVBE program could be improved with legislation aimed at providing incentives for DVBE participation and penalties for bidders who do not comply with program requirements.

Legislation establishing the DVBE program does not have adequate provisions to ensure compliance with program goals.

To increase the efficiency and effectiveness of the DVBE program, we recommended the Legislature consider doing the following:

- Replace the current good-faith effort step requiring bidders to contact the federal government with a step directing bidders to contact General Services for a list of certified DVBEs.
- Enact a contracting preference for DVBEs similar to the one for the small business program—that is, allow an artificial downward adjustment to the bids from contractors that plan to use a DVBE to make the bids more competitive.
- Require awarding departments to go through their own good-faith effort in seeking DVBE contractors.
- Provide awarding departments with the authority to withhold a portion of the payments due to contractors when they fail to use DVBEs to the extent specified in their contracts.

➲ ***Legislative Action: None.***

We found no indication that the Legislature has passed legislation addressing the recommendations presented above.

DEPARTMENT OF FISH AND GAME

Investigations of Improper Activities by State Employees, August 2002 Through January 2003

ALLEGATIONS I2002-636, I2002-725, AND I2002-947 (I2003-1), APRIL 2003

Department of Fish and Game's response as of February 2003[1]

We asked the Department of Fish and Game (department) to investigate on our behalf allegations that a regional manager claimed vacation and sick leave hours he was not entitled to receive, engaged in various contracting improprieties, and mistreated employees.

Investigative Highlights . . .

Employees of the Department of Fish and Game (department) engaged in the following improper governmental activities:

- ☑ *Improperly claimed 479 hours of leave balances, a benefit worth approximately $20,322, to which he was not entitled.*
- ☑ *Circumvented competitive-bidding requirements.*
- ☑ *Violated conflict-of-interest prohibitions.*
- ☑ *Mistreated subordinates and breached other norms of good behavior in a way that brought discredit to the department.*

Finding #1: The department mismanaged its leave-accounting system.

A manager of one of the department's regions failed to ensure his region made monthly updates to the State's leave-accounting system for more than two years, and even after the region took steps to bring the system up to date, the manager improperly claimed 479 hours of leave balances to which he was not entitled.

The State's leave-accounting system tracks vacation, sick leave, and annual leave as well as other employee leave balances, such as compensatory time off and personal holidays. The leave-accounting system automatically posts credits to the employees' monthly leave balances, but regional staff must account for any leave its employees have taken—which it had not done for more than two years. Thus, for the 180 regional employees the manager oversaw, the region reported leave balances that were greater than the employees' actual balances. In doing so, the region exposed the State to undue liability in that employees might have taken more leave than they were entitled to. Also, employees may have found planning vacations difficult, given

[1] Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2004, this is the date of the auditee's latest response.

that they did not receive an accurate accounting of their leave balances. To correct this problem, regional staff, under the manager's direction, began reconciling each employee's leave balances. In most cases, staff assigned to perform the reconciliation easily resolved cases in which individuals identified discrepancies. In some instances regional staff were unable to locate employees' time sheets. In such cases, their only recourse was to grant those employees the automatic leave accrual, even though the employees might already have taken time off, because the region lacked supporting documentation by which to reduce the employee's leave balances. However, some controversy remained involving the manager's leave balances. The manager disputed his staff's recalculation and rather than provide documentation to support his dispute, he supplied staff with amounts he believed were correct. When the department's investigators questioned him, the manager stated that he had support for these adjustments; however, after reviewing the information the manager provided, the department concluded that the support was inadequate. The department concluded that the manager received a combined 479 hours of sick leave and annual leave that he was not entitled to, a benefit worth approximately $20,322.

Finding #2: The manager and other employees violated contracting and conflict-of-interest laws.

Contrary to state laws, regional staff split various transactions into smaller ones enabling them to circumvent competitive bidding requirements. These transactions related to the purchase of equipment or services provided by companies that a seasonal employee of the department owned or was affiliated with. For example, from February through June 2001, two companies—the employee owned one and founded the other—invoiced the department a total of $62,000 for five underground storage tanks used to provide water for sheep and deer. Instead of treating this as one transaction, regional staff spread these costs among five purchase orders, thereby circumventing competitive-bidding requirements. In addition, supporting documents associated with the purchase of the five underground storage tanks lacked evidence that the department actually obtained competitive bids. The manager and regional staff also allowed one of the companies to begin work related to the underground storage tanks before the department had established contracts for the work, thereby exposing the State to additional liabilities. The department concluded that the seasonal employee violated

conflict-of-interest prohibitions because one of his companies submitted a $10,667 invoice for one underground storage tank at the time he was a state employee.

Finding #3: The manager mistreated subordinates.

The department investigated several complaints concerning the manager's conduct and concluded that the manager made sexually suggestive comments or jokes in the presence of female staff members (who found his comments offensive), made inappropriate gestures to a staff member on several occasions, repeatedly cursed in staff members' presence, and intimidated staff by yelling at them to an extent that they perceived as unprofessional.

Department Action: Corrective action taken.

The department initiated an administrative action against the manager for violating provisions of the Government Code: inexcusably neglecting his duty; treating the public or other employees inappropriately; and breaching other norms of good behavior, either during or after duty hours, in a way that discredited the department. A subsequent May 2002 agreement between the department and the manager called for a reduction in the manager's pay by 5 percent for five months, a reduction in his leave balances by 479 hours; and required the manager to complete department-specified training, including topics on management techniques, equal employment opportunity, conflicts of interest, and contracting. However, the department did not reduce the manager's leave balances by the agreed-upon amounts until February 4, 2003, after we made further inquiries into the matter.

CALIFORNIA INTEGRATED WASTE MANAGEMENT BOARD

Its New Regulations Establish Rules for Oversight of Construction and Demolition Debris Sites, but Good Communication and Enforcement Are Also Needed to Help Prevent Threats to Public Health and Safety

REPORT NUMBER 2003-113, DECEMBER 2003

Responses of the California Integrated Waste Management Board, the County and the City of Fresno, and the County and the City of Sacramento as of December 2003

Audit Highlights . . .

Our review of the California Integrated Waste Management Board (board) and local agencies' oversight of solid waste facilities found:

- ☑ *The board had not finalized regulations for construction and demolition debris sites when a large fire broke out at the Archie Crippen Excavation Site (Crippen Site), which accepted construction and demolition waste in Fresno.*
- ☑ *The board's interim directions did not provide the local enforcement agencies (LEAs) with clear guidance on how to handle construction and demolition debris sites.*
- ☑ *Representatives of several agencies visiting the Crippen Site before the fire failed to cite and remediate conditions that ultimately made the fire difficult to suppress, raising concerns about public health.*
- ☑ *The board does not track "excluded" solid waste sites because regulations do not require it to do so.*

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Each year Californians generate an estimated 66 million tons of solid waste, which must be properly handled to prevent health and environmental threats. In 1976 Congress enacted the Resource Conservation and Recovery Act of 1976, which expanded the federal government's role in regulating the disposal of solid wastes and required that all solid waste landfills comply with certain minimum criteria adopted by the U.S. Environmental Protection Agency. In that same year, when cities and counties became responsible for enforcing these standards, each local government, with the California Integrated Waste Management Board's (board) approval, designated a local enforcement agency (LEA) to enforce state minimum standards and solid waste facility permits.

Our audit concluded that, although the board has established regulations for many types of solid waste streams, it could have improved its interim guidance in its LEA Advisory #12 (advisory) for areas pending regulation. While the board was preparing regulations for construction and demolition debris waste sites, a serious fire broke out at the Archie Crippen Excavation Site (Crippen Site), which accepted construction and demolition debris, in Fresno, resulting in a threat to public health and suppression and cleanup costs of over $6 million. Further, the board has established a system for reviewing LEAs' performance that meets statutory requirements for scope, but not for frequency.

- ☑ *The board does not complete a review of each LEA every three years, as required by law.*
- ☑ *Through legal challenges to enforcement actions, solid waste facility operators can delay correction of identified problems.*

Finding #1: Until recently, the board had only an advisory statement in place of regulations for construction and demolition debris sites.

While working on regulations for construction and demolition debris sites during the last six years, the board advised the LEAs to follow its advisory for permitting of "nontraditional" facilities, including construction and demolition debris waste sites. The advisory's purpose is to guide LEAs and board staff on the permitting of nontraditional facilities with activities not yet covered by regulations. "Nontraditional facilities" are those facilities other than landfills, transfer stations, and composting facilities that handle or process solid waste. Although not precluding LEAs from accepting applications for solid waste facility permits at these sites, the advisory strongly encourages LEAs not to accept applications for solid waste facility permits for materials and handling methods that are under evaluation. However, the advisory also states that should an LEA consider a facility proposal that appears to fall into the nontraditional facility category, but not be certain whether the advisory's interim policy applies to the particular facility, the LEA can contact the board's permitting branch representative for assistance.

In August 2003, after many draft proposals and public comments, the first phase of the regulations became effective, covering the transfer and processing of construction and demolition debris. At that time, work was also progressing on the second phase, dealing with the disposal of construction and demolition debris. The board has indicated it adopted regulations for construction and demolition debris disposal in September 2003, and they are scheduled to become effective in January 2004.

We recommended that to meet the goals of the California Integrated Waste Management Act of 1989 (Waste Act) and improve regulation of solid waste, the board should complete and implement as promptly as possible its work on the second phase of regulations for construction and demolition debris sites, covering the disposal of the waste materials.

Board Action: Partial corrective action taken.

The board stated that on September 17, 2003, it adopted the second phase of regulations for construction and demolition debris sites. In addition, on November 10, 2003, the regulations were submitted to the Office of Administrative Law (OAL) for approval. OAL's 30 working day review period

ended on December 26, 2003. The regulations will become effective soon after approval by OAL and filing with the Secretary of State.

Finding #2: Concerns about the Crippen Site were not addressed.

In the two years before the Crippen Site fire, staff of the city of Fresno Code Enforcement Division, the city of Fresno Fire Department, the Fresno LEA, and the board visited the site. According to the city of Fresno's Planning Commission resolution to revoke the Crippen Site's conditional use permit after the fire, the Crippen Site had accumulated material in type and quantity that violated the terms of the conditional use permit, and the debris pile had existed for at least seven years before the fire. Thus, staff of each of these agencies observed the conditions at the Crippen Site. However, because of questions about the board's written direction in its advisory and verbal directions to the LEA at the time of the board staff's visit to the Crippen site, lack of communication between some of these agencies, and failure to cite the conditions, the problems at the Crippen Site were not remediated.

We recommended that to ensure sites are adequately monitored, the board should clarify the intent of the advisory for currently known or newly identified nontraditional sites for which regulations are not yet in place. For example, the board should resolve the ambiguity between the advisory's statement that LEAs are strongly encouraged not to accept applications for solid waste facility permits for materials and handling methods under evaluation, on the one hand, and its statement that it is ultimately the responsibility of the LEAs to determine whether to require solid waste facility permits for such sites, on the other hand. In addition, when it determines that an LEA has inappropriately classified a site—for example, treating a composting site as a construction and demolition debris site—the board should work with the LEA to correct the classification.

Board Action: Pending.

The board has stated that subsequent to the adoption of Phase II of the Construction and Demolition Debris and Inert Debris regulations, board staff determined that the advisory no longer provided needed guidance and therefore suspended it. Further, the board stated that it will continue to assist LEAs in placing solid waste handling activities,

including ones handling new or unique waste streams, within the appropriate tier of the regulatory framework. In addition, the board stated that this assistance will continue to include periodic training on the regulations, solid waste facility type definitions, and tier permit requirements, as well as ongoing technical support through direct contact with board staff and through the board's Web site.

Finding #3: Questions arose about the city of Fresno's handling of the Crippen Site fire.

During a hearing of a Senate select committee on air quality in the Central Valley, questions arose about the city of Fresno's preparedness for the Crippen Site fire, its fire-fighting techniques, and its timing of requests for expert assistance. In April 2003 a city of Fresno task force made up of concerned citizens, representatives of various interest groups, city and county officials and staff, and current and former members of the City Council issued its report on the events associated with the Crippen Site fire and made 24 recommendations for addressing identified problems. Areas the recommendations covered included, but were not limited to, issuing of permits, monitoring sites with conditional use permits, setting staffing levels and providing training, determining the adequacy of policies and procedures for code enforcement, establishing adequate means for communicating warnings about health hazards, and assessing the adequacy of the emergency response plan. As of late October 2003 the city's status report on its implementation of the recommendations indicated that only seven recommendations remained outstanding.

We recommended that to ensure it appropriately permits, monitors, and enforces compliance with the terms of its conditional use permits and has an adequate system in place to deal with emergencies, such as the Crippen Site fire, the city of Fresno should continue to implement the remaining recommendations from its task force report on the response to the Crippen Site fire. In particular, it should ensure the proper training of staff to ensure they identify existing problems at sites with conditional use permits and effectively enforce compliance with regulations and the terms of conditional use permits, and Code Enforcement should continue implementing its proactive, risk-based monitoring of conditional use permits. It should also take steps to ensure its response to emergencies is effective and prompt.

City of Fresno Action: Partial corrective action taken.

As of November 25, 2003, the city of Fresno reported that it had implemented 21 of the 24 recommendations and expected to implement the remaining three by January 2004.

Finding #4: New regulations address the lack of oversight of construction and demolition debris sites, but certain operations still lack adequate regulation.

The board's new requirements for processing construction and demolition debris now provide regulatory guidance for oversight of facilities and operations. However, some construction and demolition operations and facilities may fit into the excluded tier of the board's regulatory system. The board's regulations do not require operators in the excluded tier to notify the LEA of their intent to operate, and such operators who increase their activity enough to require a permit are merely "honor bound" to notify the LEA of any changes that modify their current operations. If the LEA is not aware that an excluded tier activity is taking place, the LEA is unable to monitor the activity. Relying on operators to self-report or the industry to self-monitor is insufficient to ensure that all excluded tier activities are accounted for, tracked, and monitored to ensure that materials on site are stable and will not harm public health and safety.

Regulations specify that the LEA or the board can inspect an excluded tier activity to verify that the activity continues to qualify as an excluded tier activity and can take any appropriate enforcement action. However, our survey of LEAs indicated that 26 of 48 responding LEAs, including the two LEAs we reviewed, monitor excluded tier activities only by responding to complaints or reports from other entities. None of these LEAs stated that it performs periodic on-site visits or inspections outside of receiving a complaint.

Of the 48 LEAs responding to our survey, 43 told us that they track the existence of excluded tier activities when they are notified that a local government is considering a conditional use permit or when another entity or department files a complaint with the LEA. However, regulations do not require this tracking, and our visit to one LEA identified that after initially confirming that an activity falls in the excluded tier, the LEA does not track or perform any further monitoring of that activity to determine whether the operator has maintained or changed its activity

level. Also, local governments may not forward all conditional use permits to their LEAs for review, so some operations may remain unknown to the LEAs.

We recommended that to ensure the enforcement community is aware of excluded operations that could potentially grow into a public health, safety, or environmental concern, the board should require, pursuant to the Public Resources Code, Section 43209(c), LEAs to compile and track information on operations in the excluded tier. To track this information, each LEA should work with its related cities and counties to develop a system to communicate information to the LEA about existing and proposed operations in the excluded tier with the potential to grow and cause problems for public health, safety, and the environment. For example, cities and counties might forward to LEAs information about requests for conditional use permits, revisions to current conditional use permits, or requests for new business licenses. We are not suggesting that the LEA track all operations in the excluded tier—for example, backyard composting or disposal bins located at construction sites. In addition, the board should require LEAs to periodically monitor operations in the excluded tier to ensure that they still meet the requirements for this tier. Finally, in its triennial assessments of each LEA, the board should review the LEA's compliance with these requirements regarding excluded sites.

Board and the Counties of Fresno and Sacramento Actions: Pending.

The board stated that it placed operations into the excluded tier through rulemaking pursuant to the Administrative Procedures Act, which includes full participation by stakeholders and potentially affected parties. In addition, the board stated that the placement is based on professional, technical, and scientific analysis. Further, the board stated that it defines these excluded activities so that there is regulatory certainty that they do not require permits. Nevertheless, the board stated that LEAs are still responsible for being aware of changes in activities located in their jurisdiction. The board agreed that there may be some value in encouraging LEAs, in concert with other local regulatory requirements, to develop mechanisms for identifying and tracking activities that may trigger additional regulatory requirements.

Although the county of Fresno responded to the audit report, its responses did not specifically address this recommendation.

The county of Sacramento stated that the management of Solid Waste in local jurisdictions is most often carried out, through State delegation, by counties and cities. Funding of programs is an area that is a significant consideration, and it is problematic to charge fees to businesses that are exempt or in categories that may not require inspection or regulation.

Finding #5: Board evaluations are substantially appropriate in scope, but do not meet the three-year mandate.

Our review of five LEA evaluations the board completed found that the established scope of the evaluation is appropriate and that the board complied with that scope. The evaluation covers all six specific areas of interest identified in regulations and further ensures that the LEAs continue to comply with certification requirements. However, the board is not timely with its LEA evaluations, beginning or scheduling evaluations to begin on average about 11 months after the end of the mandated three-year cycle. However, the board's definition of what represents a three-year cycle increases the problem. The board defines the three-year cycle as beginning at the conclusion of the LEA's last evaluation and ending at the date the next evaluation is initiated. Our interpretation of the statutory requirement, however, is that LEA performance evaluations should be completed every three years or more frequently. Thus, if an evaluation is completed on February 1, 2001, the next should be completed no later than February 1, 2004. The board's approach, when combined with the time required to actually conduct an evaluation and develop a workplan, if necessary, may delay the discovery and resolution of potential performance shortcomings in an LEA.

We recommended that to comply with existing law, the board should complete evaluations of LEAs within the three-year cycle. If that is not feasible, the board should propose a change in law that would allow a prioritization system to ensure that it at least evaluates LEAs with a history of problems every three years.

Board Action: Pending.

The board has stated that staff believes the third cycle of LEA evaluations can be completed within the three-year cycle, partly because of the experience it has gained during the last two cycles. In addition, the board stated that its staff constantly re-examines its internal practices and will continue to work on methods to streamline the evaluation

process, such as firmer deadlines for internal fact-finding and report review. The board also stated that it will consider our suggestions as it reviews the recommendation.

Finding #6: Legal challenges can significantly delay correction of identified problems at noncomplying solid waste sites.

Even if all regulations were in place, all monitoring occurred promptly, and enforcement actions were initiated promptly, identified problems would not necessarily be corrected immediately. The process to correct violations can be lengthy, and it may involve hearings and legal proceedings, including appeals of decisions in each. The Waste Act contains a comprehensive enforcement scheme for solid waste facilities, designed to allow LEAs to bring various enforcement actions against owners and operators for violations of the Waste Act. Under certain circumstances, the board may take enforcement actions itself. This enforcement scheme includes the ability to issue a corrective action order or a cease and desist order, to administratively impose civil penalties, and to suspend or revoke a permit under certain conditions. However, this enforcement scheme allows a person who is the subject of any of these enforcement actions to request a hearing before a local hearing panel, which must be established pursuant to the requirements and procedures delineated in Public Resources Code, and then before the board. If a hearing is requested, the enforcement order is "stayed," or rendered inoperative, until all appeals to the local hearing panel and the board have been exhausted or the time for filing an appeal has expired, unless the LEA can make a finding that the activity constitutes an imminent threat to the public health and safety or environment. Consequently, a person who is the subject of an LEA enforcement order can continue the activity that is the subject of the order until all appeals have been exhausted.

We recommended that the Legislature may wish to consider amending the current provisions of the Waste Act that allow a stay of an enforcement order upon the request for a hearing, and to streamline or otherwise modify the appeal process to make it more effective and timely and enhance the ability to enforce the Waste Act.

Legislative Action: None.

We are not aware of any action taken by the Legislature regarding the Waste Act.

Board and the Counties of Fresno and Sacramento Actions: Pending.

The board stated that it may be time to re-examine the effectiveness of this provision. In addition, board staff agrees that this issue warrants further consideration.

Although the county of Fresno responded to the audit report, their responses did not specifically address this recommendation.

The city of Sacramento stated that local jurisdictions use a proactive approach utilizing education, audit (inspection), and enforcement in ensuring compliance with applicable laws and regulations. The current mandated process for solid waste enforcement is particularly cumbersome, protracted, and costly. The city of Sacramento further stated that the Legislature, CalEPA, and the board should consider allowing or mandating an enforcement process more consistent with other successful processes in the State and local environmental regulatory programs.

CALIFORNIA LAW ENFORCEMENT AND CORRECTIONAL AGENCIES

With Increased Efforts, They Could Improve the Accuracy and Completeness of Public Information on Sex Offenders

Audit Highlights . . .

*Our review of the Department of Justice's (Justice) database of **serious** and **high-risk** sex offenders, known as the Megan's Law database, disclosed the following:*

- ☑ *The Megan's Law database contains thousands of errors, inconsistencies, and out-of-date information.*
- ☑ *Because it excludes records for some serious and high-risk sex offenders and erroneously lists others as incarcerated, the Megan's Law database does not inform the public about these offenders.*
- ☑ *Conversely, because it includes hundreds of duplicate records and erroneously indicates that 1,142 incarcerated sex offenders are free, it may unnecessarily alarm the public.*
- ☑ *The address information for roughly 23,000 records in the Megan's Law database has not been updated for at least a year largely because sex offenders have not registered.*

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REPORT NUMBER 2003-105, AUGUST 2003

Department of Justice's response as of December 2003

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to evaluate the accuracy of the State's database of registered sex offenders. Further, the audit committee asked us to determine if state and local law enforcement agencies are implementing Megan's Law in a manner that maximizes the registration data's accuracy. Lastly, we were asked to identify deficiencies in the current state Megan's Law that hinder the accuracy of the sex offender data and to provide legislative recommendations to address identified deficiencies.

Finding #1: The Megan's Law database omits some records of juvenile sex offenders tried in adult courts, and inappropriately includes others.

The law provides that only juveniles with juvenile court adjudications for their sex offenses are protected from public disclosure under Megan's Law. However, we found omitted from the Megan's Law public information a total of 51 Department of the Youth Authority (Youth Authority) records of juvenile sex offenders tried in adult courts. In 20 cases, Department of Justice (Justice) staff did not mark the records as coming from adult courts; in 31 other cases, Youth Authority or Department of Corrections (Corrections) did not prepare pre-registration or notification forms or Justice did not receive or process them. Without information about *serious* and *high-risk* juvenile sex offenders tried in adult courts and released into communities, California residents have no way of knowing that they are living near these convicted offenders.

In addition to problems with the overall accuracy of the Megan's Law database, we found that Justice does not always prevent the public disclosure of juvenile sex offenders' records. Specifically, Justice erroneously disclosed to the public 42 records for sex

☑ *Although Justice maintains that its primary responsibility is to compile the sex offender data it receives from law enforcement agencies and confinement facilities, it has taken steps to improve the accuracy of the information in the Megan's Law database.*

offenders convicted in juvenile courts, thwarting the additional protection and confidentiality that the Legislature has afforded to juveniles.

To ensure that the records of juvenile sex offenders are properly classified and disclosed to the public, we recommended that Justice do the following:

- Coordinate with the Youth Authority and periodically reconcile its sex offender registry with Youth Authority information.
- Provide training to its staff regarding the proper classification of records, such as flagging juvenile records appropriately for public disclosure.
- Revise its pre-registration process with Youth Authority to include a request for court information, which can be used to properly classify juvenile records.
- Request the Judicial Council to amend its juvenile commitment form to require that Youth Authority send a copy of the form to Justice.

Justice Action: Partial corrective action taken.

Justice reports that it worked with Youth Authority to develop an automated process for updating juvenile sex offender status in the Violent Crime Information Network (VCIN) with Youth Authority data. Justice has implemented this process and plans to use it to update the VCIN monthly. It is working on other modifications that will improve data synchronization between Justice and Youth Authority, and plans to complete them by the end of January 2004. Justice also implemented new procedures and trained its staff to ensure that all juvenile sex offender records are properly classified for purposes of public disclosure. Additionally, the Judicial Council is evaluating legal issues associated with Justice's request for Youth Authority to provide more detailed court disposition information with sex offender registration documents to help facilitate the classification process.

Finding #2: The Megan's Law database omits some records with inaccurate offense codes.

Of approximately 18,000 records in the VCIN that are classified as "other" and not shown to the public, Justice identified 1,900 records that have offense code 290 rather than the more specific

offense codes for which the sex offenders were convicted. Local law enforcement agencies and Justice staff sometimes enter the 290 offense code in reference to the section of the California Penal Code that mandates registration for sex offenders when they are uncertain of the appropriate code, and the VCIN automatically classifies records with this offense code as "other." Records classified as other are not included in the Megan's Law database and thus not disclosed to the public. Justice ultimately determines the proper offense code by researching conviction information, but stated that until recently it has not had the necessary staffing resources to do the work. Justice subsequently updated the offense code for 497 of the 1,900, raising the classification to serious for 351 of them. For most of the remaining 1,403 records, Justice is waiting for responses from other states.

We recommended that Justice continue reviewing records for which it has only the 290 offense code and update the offense codes as appropriate.

Justice Action: Corrective action taken.

Justice continues to review criminal history information to verify that registered sex offenders are properly classified for purpose of public disclosure in the Megan's Law database. As of December 9, 2003, Justice has reviewed approximately 15,500 of the approximate 18,000 sex offenders classified as "other," resulting in the reclassification of 1,390 of these sex offenders to "serious." Justice is in the process of researching the remaining 2,500 records, most of which have offense code 290, and has requested conviction information from courts.

Finding #3: Some sex offender records continue to indicate the incarcerated status after offenders are discharged from prison or paroled, while others show incarcerated sex offenders as residing in local neighborhoods.

We found that for 582 records in VCIN that indicate the offenders are in prison, there were no records with matching Criminal Information and Identification (CII) numbers on Corrections' list of inmates. A sample of 59 of these revealed that 48 of the offenders were no longer in prison. Another 1,142 records incorrectly indicate the sex offenders are free when, in fact, they are incarcerated. Additionally, of 2,575 records Justice identified as pending release from prison for more than a year, 1,787 of these offenders had already been released. Because Justice does not review Corrections' monthly list of prison inmates to identify sex offenders who

appear on the list one month but not the next, it does not know if Corrections should have completed a form notifying Justice and local law enforcement that it will soon be releasing a sex offender or that one has died, and Justice does not know which offenders require follow-up to determine their true status. Unless Justice corrects these records or these offenders register, their records in the Megan's Law database will continue to incorrectly indicate that they are incarcerated.

We recommended that Justice regularly compare its records showing the incarcerated status with information provided by Corrections to determine which sex offenders are confined and those who are no longer in confinement, continue to work with Corrections to improve this process, and produce exception reports to resolve those records in question. Justice can then update these records appropriately.

Justice Action: Pending.

Justice is in the process of modifying the program it uses to update the VCIN using Corrections' list of incarcerated sex offenders, so that an offender's incarceration status will be removed from the Megan's Law database when it no longer appears on Corrections' list. The offender's status will automatically change to "released" and a violation notice will be activated if the offender does not register with local law enforcement as required. Justice is also modifying the VCIN to generate violation notices based on the date of release, rather than on the date of notification, as reported in the pre-release notification documents. Justice anticipates it will complete these changes by the end of January 2004. According to Justice, these changes will significantly reduce future discrepancies between Justice's and Corrections' data.

To the extent possible, Justice and Corrections will pursue other methods for ensuring complete synchronization of sex offender data. However, Justice believes that it would not be practical to generate monthly exception reports as a means of identifying any sex offender records that cannot be properly matched to Corrections' data. It says that the use of such reports would be extremely time-consuming, since it would potentially require the manual research of thousands of possible matches each month.

Finding #4: The Megan's Law database includes hundreds of duplicate records primarily created by personnel who lack adequate training.

We identified 437 records in the Megan's Law database that were obvious duplicates of other database records. Consequently, the public cannot rely on the sex offender information shown in a zip code search to identify the number of offenders in a specific community. The public also cannot rely on the information retrieved from the Megan's Law database in response to a search for a specific sex offender by name, because more than one record can appear for an offender and, without dates on the records, the public cannot determine which record is the most current.

Personnel who update sex offender records create duplicate records because they do not always search for existing records before creating new ones. According to Justice's policies and procedures, when a sex offender registers, personnel updating sex offender records are required to search the database to determine if the offender matches existing records. However, Justice has not provided sufficient training to its personnel and to all local law enforcement agencies that update sex offender records. For example, we found that personnel at one city's police department entered 89 of the 437 duplicate records.

We recommended that Justice periodically analyze its data to identify and eliminate obvious duplicates. As a first step, Justice should review the bureau's analysis identifying obvious duplicate records and eliminate these duplicate records. Additionally, to ensure that local law enforcement and its own staff update sex offender information appropriately, we recommended that Justice design and implement an appropriate training program.

Justice Action: Partial corrective action taken.

Justice has implemented an improved system for identifying duplicate records in the VCIN through a specially designed data-string search and manual verification process. As a result of the initial search conducted in August 2003, Justice identified and eliminated 512 duplicate records from the database. In late October 2003, Justice began these searches on a weekly basis and as of December 9, 2003, identified 273 additional duplicate records, which it has merged and deleted. These weekly searches will augment the existing process of identifying duplicate records based on a cross match of CII numbers.

In addition, by mid-2004 Justice plans to complete the programming necessary to implement Live Scan, an electronic fingerprinting technology, allowing local law enforcement agencies to electronically transmit to Justice the offenders' fingerprints with each registration transaction. The fingerprints will be automatically verified for immediate and reliable identity confirmation, which according to Justice, will eliminate duplicate entries.

Also, Justice has been working with local law enforcement agencies to research and identify options for providing a statewide training program designed to improve the accuracy of sex offender data from both data entry and field enforcement standpoints. To determine how best to deploy its limited training staff, Justice has been soliciting local agency input regarding their need for training and other assistance through field contact, surveys, and a regional law enforcement meeting. Based on this input, Justice will modify its existing technical training program to focus on problem areas, incorporate enforcement strategies in the curriculum, and achieve greater efficiency through regional training it facilitates. Justice has trained its staff who process registration information in order to minimize technical errors that may contribute to data inaccuracy and plans to conduct this internal training on an ongoing basis.

Finding #5: The Megan's Law database does not show when sex offenders' records were updated, limiting the information's usefulness to the public.

Because the Megan's Law database does not include the dates of offenders' registrations, the public has no way of distinguishing the records recently updated from those updated long ago, thereby limiting the usefulness of the information. We found that approximately 23,000 records were last updated before April 2002, and about 14,000 of those were last updated before April 1998. Often, registrants do not comply with annual registration requirements, and many offenders with outdated information are not required to register in California because they may have moved outside the State, been deported or incarcerated, or are deceased. Without information in the Megan's Law database to tell them whether the last update was a week or five years ago, or a specific disclaimer explaining the possibility of outdated data, people viewing the database cannot evaluate the usefulness of the information they read.

We recommended that Justice modify the Megan's Law database to include the date that the registration information was last provided.

Justice Action: Corrective action taken.

Justice has modified the Megan's Law database to include a message indicating if and for how long an offender has been in violation of registration requirements. According to Justice, the message reads: "Note: This sex offender has been in violation of registration requirements since <date>." Justice states that vendors are developing foreign language translations of this message and anticipates adding them to the Megan's Law database by February 2004.

Finding #6: The public would be well served by Justice attaching disclaimers to the Megan's Law database.

Even if state and local agencies accurately reported all the information they receive, the Megan's Law database would continue to be incomplete and inaccurate as a result of sex offenders not registering as required or providing inaccurate information when they do register. Currently, Justice includes some disclaimers in the information it provides the public. However, we believe that modifying the existing disclaimers and adding others about potential inaccuracies and errors could help the public better understand and use the data to protect themselves and their families. As of the end of our audit, Justice was in the process of finalizing additional disclaimers that incorporate our suggestions.

We recommended that Justice finalize its disclaimer information and direct law enforcement agencies to provide the disclaimers to the public members who view the Megan's Law database. The disclaimer information should include the following:

- A statement that Justice compiles but does not independently confirm the accuracy of the information it gathers from several sources, including sex offenders who register at law enforcement agencies and custodians who report to Justice when sex offenders are released from confinement facilities. This statement should advise the viewer that the information can change quickly and that it would not be feasible for California's law enforcement agencies to verify the whereabouts of every sex offender at any given time.

- A statement that the information is intended not to indicate the offenders' risk to the public but to help people form their own assessments of risk.

- A statement that the location information is based on the "last reported location," which may have changed.

- A statement to remind viewers that a fingerprint comparison is necessary to positively identify a sex offender.

Justice Action: Corrective action taken.

Justice developed a comprehensive disclaimer containing the specific elements we recommended and has added the English version of this disclaimer to the Megan's Law database. Justice anticipates that translations of the disclaimer in 12 other languages will be added to the Megan's Law database by mid-January 2004.

Finding #7: Justice's review of the Megan's Law data has not been adequate.

State law declares the Legislature's intent that Justice continuously reviews the sex offender information in the Megan's Law database. However, Justice has interpreted this intent language to direct it only to continually review the accuracy of its entry of information, not of the information itself. Our legal counsel agrees with Justice that the intent language is not binding and states that because Justice is responsible for administering the Megan's Law database, it has flexibility in determining how it will fulfill the Legislature's intent that it continually review sex offender data. However, we believe Justice's review has not been adequate because the Megan's Law database is intended for the public's use in safeguarding itself from dangerous sex offenders. According to Justice, because it is only a repository, not the originating source, of much of the Megan's Law information, it is beyond the purview of Justice to ensure that information provided by courts and registering agencies is accurate.

The Associated Press reported in January 2003, based on information provided by Justice, that Justice did not know the whereabouts of 33,296 registered sex offenders because they had not registered annually as required. Subsequently, Justice determined that 663 of the 33,296 sex offenders had, in fact, registered within the past year. In addition, Justice confirmed that 2,833 sex offenders are living outside the State and

1,360 are deceased. However, Justice received either outdated, incomplete, or no information on the remaining 28,440 sex offenders who did not register.

Justice obtained information on deaths from the Department of Health Services (Health Services), deportations from the Immigration and Naturalization Service (INS), and sex offenders living in other states from the National Law Enforcement Telecommunication Services. However, until 2003, Justice had not requested death information to use for updating sex offenders' records. According to Justice, previously it did not obtain the information from Health Services or the INS because it has no underlying statutory responsibility for seeking out information from these agencies.

We recommended that Justice design and implement a program to check the data as a whole for inconsistencies and periodically reconcile the data with other reliable information. Additionally, we recommended that Justice continue to work with Health Services, the INS, and other public agencies to obtain valuable information and update the sex offenders' records.

Justice Action: Corrective action taken.

Justice has contracted with Health Services and the Social Security Administration to regularly obtain updated death certificate information. It will use this information on a quarterly basis to update sex offender information in the VCIN. Also, Justice recently compared records in the VCIN with deportation records maintained by the INS and updated the VCIN to reflect offenders identified as deported. In November 2003, Justice obtained on-line access to INS' deportation files, which will enable it to identify on an ongoing basis sex offenders who have been deported. In addition, Justice has begun ongoing analysis of its sex offender database to identify and correct record errors, which includes a series of special searches for key words and unique transaction sequences that may indicate possible data entry errors.

DEPARTMENT OF HEALTH SERVICES

It Needs to Better Plan and Coordinate Its Medi-Cal Antifraud Activities

Audit Highlights . . .

Our review of the Department of Health Services' (Health Services) activities to identify and reduce provider fraud in the California Medical Assistance Program (Medi-Cal) revealed the following:

- ☑ *Because it has not yet assessed the level of improper payments occurring in the Medi-Cal program and systematically evaluated the effectiveness of its antifraud efforts, Health Services cannot know whether its antifraud efforts are at appropriate levels and focused in the right areas.*
- ☑ *Health Services has not clearly communicated roles and responsibilities and has not adequately coordinated antifraud activities both within Health Services and with other entities, which has contributed to some unnecessary work or ineffective antifraud efforts.*
- ☑ *An updated agreement with the California Department of Justice could help Health Services better coordinate investigative efforts related to provider fraud.*

continued on next page

REPORT NUMBER 2003-112, DECEMBER 2003

Departments of Health Services' and Justice's responses as of December 2003

The Joint Legislative Audit Committee (audit committee) asked us to review the Department of Health Services' (Health Services) reimbursement practices and the systems in place for identifying potential cases of fraud in the Medi-Cal program, with the aim of identifying gaps in California's efforts to combat fraud. Many of the concerns we report point to the lack of certain components of a model fraud control strategy to guide the various antifraud efforts for the Medi-Cal program. Specifically, we found:

Finding #1: Health Services lacks some components of a model fraud control strategy.

Although Health Services has received many additional staff positions and has established a variety of antifraud activities to combat Medi-Cal provider fraud, it lacks some components of a comprehensive strategy to guide and coordinate these activities to ensure that they are effective and efficient. Specifically, it has not yet developed an estimate of the overall extent of fraud in the Medi-Cal program. Without such an assessment, Health Services cannot be sure it is targeting the right level of resources to the areas of greatest fraud risk. The Legislature approved Health Services' 2003 budget proposal for an error rate study to assess the extent of improper payments in the Medi-Cal program, and Health Services is just beginning this assessment.

In addition, Health Services has not clearly designated who is responsible for implementing the Medi-Cal fraud control program. A model antifraud strategy involves a clear designation of responsibility for fraud control, which in turn requires someone or a team with authority over the functional components that implement the antifraud program. Although Audits

- ☑ *Because it lacks an individual or team with the responsibility and authority to ensure fraud control issues and recommendations are promptly addressed and implemented, some well-known problems may go uncorrected.*
- ☑ *Health Services does not obtain sufficient information to identify and control the potential fraud unique to managed care.*

and Investigations (audits and investigations) is the central coordination point for antifraud activities within Health Services, some antifraud efforts are located in other divisions and bureaus of Health Services or in other state departments over which audits and investigations has no authority. Thus, audits and investigations' designation as the central coordination point within Health Services does not completely fill the need for an individual or team that crosses departmental lines and is charged with the overall responsibility and authority for detecting and preventing Medi-Cal fraud.

Rather than measuring the impact of its efforts by the amount of reduction in fraud, Health Services measures its success by reference to unreliable savings and cost avoidance estimates. A component of a model antifraud strategy requires evaluating the impact of antifraud efforts on fraud both before and after implementation of the effort. However, Health Services measures its efforts by the achievement of goals established during the development of its savings and cost avoidance estimates. Although antifraud efforts offer savings, they also need to be measured against their effect on the overall fraud problem to determine whether the control activities should be adjusted.

Finally, Health Services does not currently have processes to ensure that each claim faces some risk of fraud review. According to Health Services, although its current claims processing system subjects each claim to certain edits and audits, it does not subject each claim to the potential for random selection and in-depth evaluation for the detection of potential fraud. The 2003 budget proposal included establishing a systematic process to randomly select claims for in-depth evaluation and this is one of the components the Legislature approved.

We recommended that Health Services develop a complete strategy to address the Medi-Cal fraud problem and guide its antifraud efforts. This should include adding the currently missing components of a model fraud control strategy, such as an annual assessment of the extent of fraud in the Medi-Cal program, an outline of the roles and responsibilities of and the coordination between Health Services and other entities, and a description of how Health Services will measure the performance of its antifraud efforts and evaluate whether adjustments are needed.

Health Services' Action: Pending.

Health Services stated that it is in the process of implementing the model fraud control strategies. It has received federal funding for evaluating and measuring payment accuracy and will develop plans for annual payment accuracy studies that will aid in allocating resources and evaluating fraud deterrence and detection efforts. Health Services also stated that it will document the roles and responsibilities of the various programs participating in antifraud efforts and will work with the Health and Human Services Agency to improve the coordination of antifraud activities with other departments under its authority.

Finding #2: Health Services has not yet conducted routine and systematic measurements of the extent of fraud in the Medi-Cal program.

Health Services has not systematically assessed the amount or nature of improper payments in the Medi-Cal program. Improper payments include any payment to an ineligible beneficiary, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for applicable discounts. Without this information, Health Services does not know whether it is overinvesting or underinvesting in its payment control system, or whether it is allocating resources in the appropriate areas.

The Legislature approved portions of Health Services' May 2003 budget proposal including an error rate study and random sampling of claims. Building upon its authorization to conduct an error rate study, in August 2003 Health Services applied to the federal Centers for Medicare and Medicaid Services to participate in its Payment Accuracy Measurement (PAM) project for fiscal year 2003–04. In its PAM proposal, Health Services stated that it would develop an audit program to accomplish certain objectives, including identifying improper payments, and a questionnaire to confirm that a beneficiary actually received the services claimed by the provider. However, until Health Services completes its audit program and procedures, it is premature to conclude on the adequacy of its approach to verify services with beneficiaries to estimate the level of fraudulent payments.

We recommended that Health Services establish appropriate claim review steps, such as verifying with beneficiaries the actual services rendered, to allow it to estimate the amount of fraud in the Medi-Cal program as part of its PAM study. We also recommended that it ensure the payment accuracy benchmark developed by the PAM model is reassessed by annually monitoring and updating its methodologies for measuring the amount of improper payments in the Medi-Cal program.

Health Services' Action: Pending.

Health Services reported that it will ensure an appropriate claim review step is included to verify with the beneficiary that actual services were rendered. It also plans to reassess monitoring and measurement methodologies annually.

Finding #3: Health Services does not evaluate the effect on the extent of fraud of its antifraud activities and uses unreliable savings estimates.

Health Services does not perform a cost-benefit analysis for each of its antifraud activities, nor does it use reliable savings estimates to justify its requests for additional antifraud positions. According to Health Services, it uses a form of cost-benefit analysis, using estimated savings or cost avoidance as the benefit, to make decisions regarding resource allocations. Health Services indicated that it looks at the costs and savings of its antifraud activities in the aggregate and not by specific activity because not all the fraud positions it received are directly involved in savings and cost avoidance activities. Although it acknowledged that it does not use a formal cost-benefit analysis, Health Services asserts that it performs an intuitive type of assessment.

Health Services computes a savings and cost avoidance chart (savings chart) to estimate the savings it expects to achieve from its antifraud activities in the current and budget year. Health Services also uses the savings chart to quantify the achievements of each of its antifraud activities in the prior year and as a management tool to allocate resources. Health Services used the savings chart it created in November 2002 to support its request for 315 new positions for antifraud activities in its May 2003 budget proposal, of which the Legislature ultimately approved 161.5 positions.

However, Health Services' November 2002 savings chart potentially overstates its estimated savings because of a flaw in the methodology it uses to calculate the savings. Health Services

calculates its savings and cost avoidance estimates for some categories by using the average 12-month paid claims history of providers who have been placed on administrative sanctions. Health Services assumes that 100 percent of the claims it paid during the prior 12-month period to those providers sanctioned in the current year would be savings in the budget year. However, it does not perform any additional analysis to determine what proportion of the sanctioned providers' paid claims was actually improper. We questioned the soundness of Health Services' methodology because even though the improper portion of the claim history would be potential savings, any legitimate claims submitted by the sanctioned provider could continue as a program cost for beneficiaries who would presumably receive health care services from another provider who would bill the program.

We recommended that Health Services perform cost-benefit analyses that measure the effect its antifraud activities have on reducing fraud. Additionally, it should continuously monitor the performance of these activities to ensure that they remain cost-effective.

Health Services' Action: Pending.

Health Services stated that through the use of enhanced data analysis software and relationships with its various contractors, it will develop a standard cost-benefit analysis methodology for each antifraud proposal.

Finding #4: The provider enrollment process continues to need improvement.

Health Services' Provider Enrollment Branch (enrollment branch) screens applications to ensure that the providers it enrolls are eligible to participate in the Medi-Cal program. This includes ensuring that all Medi-Cal providers have completed applications, disclosure statements, and agreements on file, to help it determine whether providers have any related financial and ownership interests that may give them the incentive to commit fraud or were previously convicted of health care fraud. It also must suspend those Medi-Cal providers whose licenses and certifications are not current or active. Although these activities are important first lines of defense in preventing fraudulent providers from participating in the Medi-Cal program, the enrollment branch is not fully performing either of these activities.

In our May 2002 report, *Department of Health Services: It Needs to Significantly Improve Its Management of the Medi-Cal Provider Enrollment Process,* Report 2001-129, we made a number of recommendations to improve the provider enrollment process. However, the enrollment branch has not fully implemented many of these recommendations. For example, we recommended that the enrollment branch use its Provider Enrollment Tracking System to ensure that it sends notifications to applicants at proper intervals. However, the enrollment branch still does not track whether it sends the required notifications to applicants, nor does it notify a provider when an application is sent to audits and investigations for secondary review.

New legislation that took effect on January 1, 2004, increases the importance of sending these notifications. If the enrollment branch does not notify applicants within 180 days of receiving their applications that their application has been denied, is incomplete, or that a secondary review is being conducted, it must grant the applicant provisional provider status for up to 12 months. Moreover, this new legislation requires these notifications for applications be received before May 1, 2003. As of September 29, 2003, the enrollment branch had 1,058 applications still open that it received before May 1, 2003. If the enrollment branch did not notify these applicants of its decision on or before January 1, 2004, it must grant them provisional provider status regardless of any ongoing review.

It is noteworthy that when the enrollment branch refers applications to audits and investigations for secondary review, the processing time typically extends well beyond 180 days. Because audits and investigations currently has about a six-month backlog, the first thing an analyst does when performing a preliminary desk review is contact the applicant to verify the current address and continued interest in applying to the program. The analyst also redoes some of the screening previously performed by the enrollment branch, such as checking to confirm that the applicant's license is valid, resulting in inefficiencies and further extending the time applicants are left waiting.

Health Services is unable to ensure that all provider applications are processed consistently and in conformity with federal and state program requirements. The enrollment branch reviews applications for certain provider types, such as physicians, pharmacies, clinical labs, suppliers of durable medical equipment, and nonemergency medical transportation. The enrollment

branch checks a variety of sources to confirm licensure, verify the information provided on the application, confirm that the applicant has not been placed on the Medicare list of excluded providers, and refers many applications to audits and investigations for further review. However, other divisions within Health Services and other departments responsible for reviewing certain types of provider applications and recommending provider enrollment do not conduct a similar review. Since different units and departments screen providers against different criteria, Health Services may be allowing ineligible individuals to participate as providers in the Medi-Cal program.

Health Services' procedures are not always effective to ensure that enrolled providers remain eligible to participate in the Medi-Cal program. Our review of 30 enrolled Medi-Cal providers that Health Services paid in fiscal year 2002–03 disclosed two with canceled licenses. Even though state law requires providers whose license, certificate, or approval has been revoked or is pending revocation to be automatically suspended from the Medi-Cal program effective on the same date the license was revoked or lost, as of August 2003, the provider numbers for both of these providers were being used to continue billing and receiving payment from the Medi-Cal program every month since the cancellations occurred. Our review of the 30 selected providers also found that, despite the fraud prevention capabilities these required disclosures and agreements provide, the enrollment branch did not always have the agreements and disclosures required by state and federal regulations. Two of the 30 provider files we reviewed did not contain disclosure statements, and Health Services could not locate agreements for 24 of these providers. The disclosure statements provide relevant information to ensure that the provider has not been convicted of a crime related to health care fraud, and that the provider does not have an incentive to commit fraud based on the financial and ownership interests disclosed. The provider agreements give Health Services a certification that the provider will abide by federal and state laws and regulations, will disclose all financial and ownership interests and criminal background, will agree to a background check and unannounced visit, and will agree not to commit fraud or abuse.

Our May 2002 audit recommended that the enrollment branch consider reenrolling all provider types. Reenrollment would improve the enrollment branch's ability to ensure that all providers have current licenses, disclosure statements, and agreements on file. Although the enrollment branch has begun

reenrolling certain provider types it has identified as high risk, it has not developed a strategy to reenroll all providers and does not have a process to periodically check the licensure of existing providers with state professional boards. Additionally, it has not completed an analysis to determine what resources it would need to reenroll all providers.

To improve the processing of provider applications, we recommended that Health Services complete its plan and related policies and procedures to process all applications or send appropriate notifications within 180 days, complete the workload analysis we recommended in our May 2002 audit report to assess the staffing needed to accommodate its application processing workload, and improve its coordination of efforts between the enrollment branch and audits and investigations to ensure that applications, as well as any appropriate notices, are processed within the timelines specified in laws and regulations.

To ensure that all provider applications are processed consistently within its divisions and branches and within other state departments, we recommended that Health Services ensure that all individual providers are subjected to the same screening process, regardless of which division within Health Services is responsible for initially processing the application. In addition, we recommended that Health Services work through the California Health and Human Services Agency to reach similar agreements with the other state departments approving Medi-Cal providers for participation in the program.

To ensure that all providers enrolled in the Medi-Cal program continue to be eligible to participate, we recommended that Health Services develop a plan for reenrolling all providers on a continuing basis; enforce laws permitting the deactivation of providers with canceled licenses or incomplete disclosures; and enforce its legal responsibility to deactivate provider numbers, such as when there is a known change of ownership. Further, we recommended that Health Services establish agreements with state professional licensing boards so that any changes in license status can be communicated to the enrollment branch for prompt updating of the Provider Master File.

Health Services' Action: Pending.

Health Services stated it has taken some steps to improve the processing of provider applications and has created a workgroup to establish a complete work plan for processing applications as required by the new legislation. It will also evaluate the internal workload study on application processing and finalize the analysis. With the addition of new staff to enhance antifraud efforts, Health Services noted that provider enrollment and audits and investigations began to develop closer working relationships, and cited various actions taken to improve communication and coordination. In addition, its programs will participate and coordinate internally, as well as with other departments, programs, and entities that perform similar enrollment functions with the aim of using consistent enrollment processing procedures. Finally, Health Services indicates that it is developing a plan to reenroll all providers, will improve its procedures to ensure that provider numbers are properly deactivated, and is working with professional licensing boards to obtain provider permit and licensing information that is timely and readily useable.

Finding #5: The pre-checkwrite process could achieve more effective results.

Health Services has a review process it calls pre-checkwrite that identifies and selects certain suspicious provider claims for further review from the weekly batch of claims approved for payment. Although the pre-checkwrite process appears effective in identifying suspicious providers, Health Services does not review all of the providers flagged as suspicious. Moreover, Health Services does not delay the payments associated with suspect provider claims pending completion of the field office review.

We reviewed 10 weekly pre-checkwrites, which identified a total of 88 providers with suspicious claims from which Health Services selected 47 for further review. At the time of our audit, 42 provider reviews had been completed, and 31, or 74 percent, of these had resulted in an administrative sanction and referral to the Investigations Branch (investigations branch) or to law enforcement agencies. According to Health Services, limited staffing precludes it from reviewing all suspicious providers. Health Services states that it must perform additional analysis to develop sufficient evidence and a basis for placing sanctions, including withholding a payment or placing utilization controls on providers.

However, when Health Services does not promptly complete its reviews and suspend payment of suspicious provider claims until it completes its on-site review, its pre-checkwrite process loses its potential effectiveness as a preventive fraud control measure. Health Services could use existing laws to suspend payments for claims that its risk assessment process identifies as potentially fraudulent or abusive and release them once a pre-checkwrite review verifies the legitimacy of the claim. Although laws generally require prompt payment, they make an exception for claims suspected of fraud or abuse and for claims that require additional evidence to establish their validity.

We recommended that Health Services consider expanding the number of suspicious providers it subjects to this process, prioritize field office reviews to focus on those claims or providers with the highest risk of abuse and fraud, and use the clean claim laws to suspend payments for suspicious claims undergoing field office review until it determines the legitimacy of the claim.

Health Services' Action: Pending.

Health Services stated that it received additional staffing in fiscal year 2003–04 to expand the number and timeliness of pre-checkwrite reviews. It also indicated it will work with its legal office to maximize the pre-checkwrite activities and develop criteria to suspend specific claims and hold checks until the review is complete.

Finding #6: Health Services and the California Department of Justice have yet to fully coordinate their investigative efforts.

Although Health Services is responsible for performing a preliminary investigation and referring all cases of suspected provider fraud to the California Department of Justice (Justice) for full investigation and prosecution, it does not refer cases as required. Moreover, Health Services and Justice have been slow in updating their agreement even though the agreement is required by federal regulations and could be structured to clarify and coordinate their roles and responsibilities and, thus, help prevent many of the communication and coordination problems we noted with the current investigations and referral processes.

Our comparison of fiscal year 2002–03 referrals of suspected provider fraud cases from Health Services' case-tracking system database to similar records from Justice's case-tracking system

database revealed that 63 (41 percent) of the 152 Health Services case referrals to Justice were late, incomplete, or never received. According to Justice, it did not include 60 of the 63 referrals in its database because they were incomplete when Justice received them or it received them close to the date of indictment by an assistant U.S. Attorney for the Eastern District of California (U.S. Attorney). For the remaining three cases, although Health Services asserts that it referred them to Justice, Health Services could not provide documentation that clearly demonstrates its referral of them. Our review of 14 investigation cases corroborated that Health Services' investigations branch referred cases to Justice late; Health Services referred 12 an average of nearly five months after the date it had evidence of suspected fraud.

Although Health Services acknowledged that referring cases to Justice after indictment by the U.S. Attorney is no longer its practice, according to the investigations branch, it investigates and refers cases to the U.S. Attorney because the U.S. Attorney indicts suspected providers and settles cases quickly. Justice, on the other hand, typically focuses on developing cases for trial to pursue sentences that it believes reflect the seriousness of the defendant's conduct. Although both approaches have merit, depending on the particular case, Health Services and Justice have not come to an agreement on when each approach is appropriate and who should make that determination.

Additionally, according to Health Services' investigations branch chief, because neither federal nor state laws provide a clear definition of what constitutes suspected fraud, the investigations branch can refer cases to Justice at varying points in the process, including before, during, or after it has met the reliable evidence standard. Admittedly, the law does not clearly define what constitutes suspected fraud, but Health Services and Justice should reach an agreement on what standard must be met to assist both agencies in coordinating their respective provider fraud investigation and prosecution efforts.

The agreement between Health Services and Justice that is required by federal regulations could help alleviate many of the current problems about when Health Services should refer cases to Justice. Over the last several years, Health Services and Justice have intermittently discussed an update of the existing 1988 agreement. However, these two entities have yet to complete negotiations for an update of this agreement or to define and coordinate their respective roles and responsibilities for investigating and prosecuting suspected cases of Medi-Cal provider fraud.

We recommended that Health Services promptly refer all cases of suspected provider fraud to Justice as required by law and that both Health Services and Justice complete their negotiations for a current agreement. The agreement should clearly communicate each agency's respective roles and responsibilities to coordinate their efforts, provide definitions of what a preliminary investigation entails and when a case of suspected provider fraud would be considered ready for referral to Justice.

To ensure that Health Services and Justice promptly complete their negotiations for a current agreement, we recommended that the Legislature consider requiring both agencies to report the status of the required agreement during budget hearings.

Health Services' Action: Pending.

Health Services stated that a draft agreement would be finalized soon. It further indicated that it clarified the need to make timely referrals to Justice in its policy and procedures.

Justice Action: Pending.

Justice stated that both agencies are working quickly and in good faith to establish an agreement that will serve to strengthen the working partnership between the two agencies.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Finding #7: A more effective feedback process could strengthen Health Services' antifraud efforts.

Although audits and investigations is responsible for coordinating the various antifraud activities within Health Services, its line of authority does not extend beyond audits and investigations. What is lacking is an individual or team with the responsibility and corresponding authority to ensure that worthwhile antifraud recommendations are tracked, followed up, and implemented. Such an individual or team would provide Health Services' management with information about the status of the various projects and measures that are under way, to ensure that antifraud proposals, including those involving external entities, are addressed promptly.

Without an individual or team with the responsibility and corresponding authority to follow up and act on recommendations for strengthening its antifraud efforts, some antifraud coordination issues or detected fraud control vulnerabilities may continue to go uncorrected. For example, although Health Services' provider enrollment process is the first line of defense to prevent abusive providers from entering the Medi-Cal program, the provider enrollment process continues to need improvement. Similarly, another unresolved fraud control coordination issue is the lack of an updated agreement between Health Services and Justice related to the investigation and referral of suspected provider fraud cases. Although laws make each of these state agencies responsible for certain aspects of investigating and prosecuting cases of suspected provider fraud, the current case referral practices result in a fragmented rather than a cohesive and coordinated antifraud effort. Both agencies indicate that they have made some efforts to update their 1988 agreement, but they have yet to complete negotiations for a current agreement that spells out each agency's respective roles and responsibilities.

We recommended that Health Services consider working through the California Health and Human Services Agency to establish and maintain an antifraud clearinghouse with staff dedicated to documenting and tracking information about current statewide fraud issues, proposed solutions, and ongoing projects, including assigning an individual or team with the responsibility and corresponding authority to follow up and promptly act on recommendations to strengthen Medi-Cal fraud control weaknesses.

Health Services' Action: Pending.

Health Services recognizes the contribution a clearinghouse can potentially make and will work with the California Health and Human Services Agency to more fully explore this recommendation and different approaches for its implementation.

Finding #8: Health Services needs to give proper attention to potential fraud unique to managed care.

In addition to its fee-for-service program, Health Services also provides Medi-Cal services through a managed care system. Under this system, the State pays managed care plans monthly fees, called capitation payments, to provide beneficiaries with health care services. Although fraud perpetrated by providers and beneficiaries, similar to what occurs under the fee-for-service

system, can also occur, another type of fraud unique to managed care involves the unwarranted delay in, reduction in, or denial of care to beneficiaries by a managed care plan.

Because of incomplete survey results and its concerns about the reliability of encounter data, which are records of services provided, Health Services does not have sufficient information to identify managed care contractors that do not promptly provide needed health care. In addition, Health Services does not require its managed care plans to estimate the level of improper payments within their provider networks to assure they are appropriately controlling their fraud problems and not significantly affecting the calculation of future capitated rates.

We recommended that Health Services work with its external quality review organization to determine what additional measures are needed to obtain individual scores for managed care plans in the areas of getting needed care and getting that care promptly, complete its assessment on how it can use encounter data from the managed care plans to monitor plan performance and identify areas where it should conduct more focused studies to investigate potential plan deficiencies, and consider requiring each managed care plan to estimate the level of improper payments within its Medi-Cal expenditure data.

Health Services' Action: Pending.

Health Services stated that its new contracted vendor should be able to gather data to address the inadequacies found in the surveys. It is also assessing how it can use managed care plan data to help target areas for focused monitoring. Health Services will consult internally and with outside entities on the feasibility of implementing through appropriate contract language the requirement that managed care plans estimate the level of improper payments within their Medi-Cal expenditure data.

DEAF AND DISABLED TELECOMMUNICATIONS PROGRAM

Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services

REPORT NUMBER 2001-123, JULY 2002

California Public Utilities Commission's and Deaf and Disabled Telecommunications Program's responses as of August 2003

Audit Highlights . . .

Our review of the Deaf and Disabled Telecommunications Program (DDTP) concludes that:

- ☑ *Neither the DDTP nor the California Public Utilities Commission (CPUC) is fulfilling its responsibilities to ensure that telephone companies (carriers) are remitting required surcharges, possibly resulting in hundreds of thousands of dollars going uncollected.*
- ☑ *Only about 32 percent of certified carriers remitted surcharge payments over the last two years.*
- ☑ *Some of the DDTP's expenditures are for unreasonable or unnecessary items.*
- ☑ *The salaries of select DDTP employees average 24 percent higher than those of comparable state positions.*
- ☑ *Most DDTP contracts we reviewed comply with the Public Contract Code and contain adequate standards for contractors to adhere to.*

The Joint Legislative Audit Committee requested that we conduct an audit of the Deaf and Disabled Telecommunications Program (DDTP) and California Public Utilities Commission's (CPUC) accounting controls to determine whether they are sufficient to ensure the proper accounting of program revenues and expenditures. We were also asked to assess the DDTP's procedures for ensuring that its contracting practices comply with Public Contract Code and its methods for ensuring that the scope of its contracted work is sufficient, meets the needs of its customers, and is cost effective.

We determined that neither the DDTP nor the CPUC is fulfilling its responsibilities to ensure that telephone companies (carriers) are collecting and remitting required surcharges on intrastate telecommunications charges, possibly resulting in hundreds of thousands of dollars going uncollected. Moreover, the DDTP does not always further its mission when expending public funds, potentially leaving less money available for program services.

Finding #1: Neither the DDTP nor the CPUC maintain a reliable record of carriers that are providing services subject to the surcharge.

Although the DDTP and the CPUC share responsibility for ensuring that all mandated surcharges are remitted to the Deaf Equipment Acquisition Fund (DEAF) Trust, neither entity has a firm grasp on which carriers should be collecting and remitting these surcharges. As of April 2002, the CPUC's list of active carriers—or those currently certified to operate and/or provide telecommunications services in California—totaled 1,483. At least 68 percent of the carriers on the CPUC's active list did not remit surcharge revenue for 2000 or 2001. However,

the CPUC is not sure how many or which of these carriers are actively providing the intrastate services that are subject to the surcharge. Consequently, the CPUC could provide no definitive reason for why these carriers did not remit during the past two years. Some options include (1) they do not provide services subject to the surcharge, (2) they stopped operating before January 2000 or did not begin operating until after December 2001, (3) they do not collect the surcharge from their customers, or (4) they simply do not remit the surcharges they collect. No one knows for sure what the reason is. In any event, it is likely that some, if not many, of these carriers should be submitting surcharge revenue.

We recommended that the DDTP work with the CPUC to develop and maintain a reliable record of carriers that are providing services subject to the surcharge. We also recommended that the CPUC should require that all active carriers that do not submit surcharge revenues certify that they in fact do not provide services subject to the surcharge.

DDTP and CPUC Action: Partial corrective action taken.

As of January 1, 2003, CPUC staff assumed responsibility for developing and maintaining a reliable record of carriers providing services and monitoring the payment history of these carriers. The CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database, which encompasses all functions of carrier activity, including carrier reporting and carrier remittance monitoring. The database reviews bank deposits to ensure carriers' monthly reporting of their billings that are subject to surcharges as well as to determine the correct payment of surcharges by the carriers. Further, the CPUC stated it has improved its own Telecommunications Division Carrier Database, which currently has 1,758 licensed telecommunications carriers. The CPUC flagged 368 carriers as having invalid mailing addresses and will investigate these carriers for compliance with CPUC orders. The CPUC did not specifically comment on our recommendation that it should require all carriers that do not submit surcharge revenues certify that they in fact do not provide services subject to the surcharge.

Finding #2: The DDTP does not adequately review or record the payments it receives.

The DDTP is responsible for reviewing incoming transmittal forms, which detail remittances, and for maintaining an accurate record of payments so it can recognize which carriers have not remitted as frequently as required. Although the DDTP receives transmittal forms, it does little more than a cursory spot check of these forms before filing them away. In addition to not reviewing these forms adequately, the DDTP does not maintain an accurate record of payments or a payment history of carriers. As a result, it has been remiss in identifying both small and large carriers that have missed payments, potentially resulting in hundreds of thousands of dollars of uncollected funds. For example, the DDTP did not recognize that one large carrier missed submitting a payment for June 2000. As of April 2002, the carrier still had not submitted the payment, which—if similar to subsequent payments—should have been approximately $200,000. Also, because the DDTP does not maintain accurate records based on the transmittal records it receives, it is unable to investigate potential discrepancies between the information recorded on the transmittal form and that in the DEAF Trust statements provided by the Bank of America, leaving potential errors unspotted.

We recommended that the DDTP track the payment history of each carrier and monitor these records to identify delinquent carriers. Also, beginning on July 1, 2003, the CPUC will ultimately be responsible for ensuring that it collects all surcharges. Thus, the CPUC will also have to monitor payment history records to ensure that carriers are remitting surcharges as required.

CPUC Action: Corrective action taken.

In order to effectively monitor surcharges remitted by carriers, the CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database. As described in corrective action for Finding 1, this database is to assist in carrier reporting and carrier remittance monitoring. The database reviews bank deposits to ensure carriers' monthly reporting of their billings that are subject to surcharges as well as determines the correct payment of surcharges by the carriers.

Finding #3: The DDTP does not identify late payments or report them to the CPUC.

The DDTP is to send out past-due notices to carriers when they have failed to remit as required and contact the CPUC concerning all delinquent surcharges. However, the DDTP does not carry out any of these procedures. Although the CPUC has ultimate enforcement power, the DDTP neither tracks which carriers are late in submitting payments nor confirms that the carriers are remitting the appropriate late-payment penalty. As a result, large amounts of revenue in the form of late-payment penalties go uncollected, and the DDTP has missed out on thousands of dollars of revenue that could be used to provide services to the deaf and disabled communities. For example, one large carrier failed to submit surcharge remittances for September and October 2001. When it finally did so on April 2, 2002—142 and 111 days late, respectively—the carrier did not submit any late-payment penalties, which should have been almost $31,000.

We recommended that the DDTP regularly notify delinquent carriers and the CPUC of all past-due amounts. We also recommended to the CPUC that it enforce late-payment penalties.

CPUC Action: Partial corrective action taken.

The CPUC stated that it continues to endorse the enforcement of late penalties and carrier certification of nonservice. Over the past year, the CPUC developed a checklist of requirements, which are placed on each carrier and imposed by the CPUC in the carrier's grant of authority. These requirements cover, among others, whether the carrier is subject to surcharge and whether it must file a written acceptance letter. According to the CPUC, having this information allows it to evaluate its expectations against carrier performance and to take actions to revoke the authority of nonperforming carriers. After reviewing the requirements of each carrier, the CPUC relayed this information to the Administrative Law Judge Division, and communicated the compliance requirements to all carriers, allowing for carrier follow-up. Nonresponsive carriers were listed in a 30-day notice period in the CPUC's daily calendar to alert them to the potential for the CPUC to revoke their authority.

In the first eight months of 2003, 16 licensed carriers contacted the CPUC on their own volition to ask the CPUC to take back the authority it had granted to the carrier to do business in California. In addition, the CPUC revoked another 135 licenses. To do so, the CPUC identifies carriers that are nonperforming according to the requirements mentioned above. After a due process, the CPUC typically revokes the authority of these carriers. In most of these cases, these carriers are no longer in business and simply do not respond to official communications, telephone calls, etc.

Lastly, we mentioned earlier that the CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database. The vendor will also develop a program that will monitor the database for carriers that have not reported Total Intrastate Billings Subject to Surcharge for a particular month. The program will also monitor for underpayment of surcharges by carriers. A letter will be sent to the carrier to resolve each outstanding problem.

Finding #4: The CPUC could improve its oversight of the DDTP and the program.

The CPUC, despite being the governing body over the program and the DDTP, does not always demonstrate consistent oversight over the carriers or the revenue collection functions performed by the DDTP. For example, the CPUC does not ensure that carriers are following its instructions regarding the collection and remittance of surcharge revenues. Specifically, we found that carriers did not consistently apply the surcharges to the different types of intrastate service charges. In addition, carriers apply different methods when reporting and paying late-payment penalties. This may be occurring because the guidance provided by the CPUC is not detailed enough. As a result, there is a great deal of inconsistency and inefficiency in the surcharge process.

Also, the CPUC is beginning to conduct remittance review audits of various carrier practices and procedures for some of its universal service programs, but it does not do so for the DDTP. Although the DDTP claims it does unofficial "spot reviews" of transmittal forms to ensure accuracy, these reviews pale in comparison to a highly detailed remittance audit. No such formal review has taken place since 1997. Unchecked carrier practices and procedures create the potential for errors that would hamper the DDTP's ability to carry out its mission.

We recommended that the CPUC rewrite its transmittal form instructions in explicit detail, ensuring consistency among carriers. In addition, the CPUC should conduct periodic remittance audits of DDTP surcharge revenues.

CPUC Action: Partial corrective action taken.

The CPUC stated that it engages consultants and in-house staff to conduct audits of its public programs, including financial audits of the DDTP program and audits of carriers' compliance with required surcharges. The CPUC recently utilized the hiring freeze exemption process to hire two Financial Examiners to work on some of these audits. Audit fieldwork by the Financial Examiners has been completed for four small local exchange carriers, and audit results are being reviewed and reports are being prepared. A contract with the Department of Finance (DOF) to perform audits on some larger carriers beginning early this fiscal year was approved in July 2003. The DOF will focus on a mid-sized local exchange carrier, a large inter-exchange carrier, and a large wireless carrier. The CPUC did not comment on rewriting its transmittal form instructions in more explicit detail.

Finding #5: The DDTP does not always further the program's mission when expending public funds.

The DDTP sometimes spends public funds on items that are unrelated to program services or that do not further the program's mission. Specifically, the DDTP has spent excessive amounts on food for training sessions, committee meetings, and other events. In addition, many program employees have DDTP credit cards, sometimes charging imprudent expenditures such as gifts and meals. Also, the DDTP has in the past reimbursed employees for expenses typically not permitted in public service, such as moving expenses and temporary rent payments. As a result, less money is available for the individuals it serves. However, the DDTP has initiated corrective action by adopting new policies on allowable expenditures.

To ensure the prudent use of public funds in furtherance of the program's mission, we recommended that the DDTP adhere to its newly revised internal control procedures that define allowable expenses.

DDTP Action: Corrective action taken.

Assembly Bill 1734, signed into law on June 20, 2002, authorized the CPUC to enter into contract(s) for the provision of the DDTP services. In July 2003, the Department of General Services (DGS) approved a contract between the CPUC and the California Communications Access Foundation (CCAF) to provide the personnel to operate the DDTP. As a result, the DDTP no longer exists in its previous form; rather the CCAF provides services previously provided the DDTP. The DDTP implemented a new policy specifically defining allowable and nonallowable expenses.

Finding #6: The DDTP has not always reported taxable fringe benefits and needs additional controls to prevent personal use of vehicles.

Previously, the DDTP failed to report to the proper taxation authorities taxable fringe benefits received by some of its employees. These benefits include paid parking and what appears to be personal use of leased vehicles. When we informed DDTP management of this, it began to initiate corrective action, including reporting parking benefits as additional income to the employee. However, the DDTP can strengthen its internal controls to prevent or record and report employees' personal use of leased vehicles.

Thus, we recommended that the DDTP develop additional procedures to prevent personal use of DDTP-leased vehicles. For example, the DDTP should label all its vehicles and require employees to maintain daily log records of miles driven. When personal use occurs, the DDTP should report it as a taxable fringe benefit to the proper taxation authorities. We also recommended that the DDTP follow its new procedures to report parking fringe benefits as taxable income on employees' W-2 forms.

DDTP Action: Corrective action taken.

As stated earlier, the DDTP no longer exists in its previous form; rather the CCAF provides services previously provided the DDTP. The DDTP's payroll service reported to the employee and the proper taxation authorities the taxable amount of any parking benefits per IRS rules. Also, the DDTP developed and implemented mileage logs, employees had

begun to log miles driven and locations visited on a daily basis, and supervisors verified the mileage driven. Finally, the DDTP also ordered decals for its leased vehicles, which state, "For Official Use Only," along with the DDTP logo.

Finding #7: Some DDTP contracts lack adequate benchmarks or standards to measure contractor performance.

Some of the contracts that we tested lacked specific performance standards for contractors as well as provisions for monetary penalties for nonperformance. The fact that the DDTP has expressed some dissatisfaction with some of the services provided exacerbates this problem. Had the DDTP established appropriate service levels, performance measures, and provisions to collect for noncompliance in the original contract, the vendors might have performed at acceptable levels or the DDTP might have collected penalties for their failure to do so.

We recommended that the DDTP ensure that all future contracts have established performance standards as well as provisions to collect damages from nonperforming contractors. Also, the program's administration will undergo some changes over the next year, including the CPUC potentially contracting out for many of the services the DDTP currently provides. Whether the CPUC contracts out for all or some of the day-to-day provision of program services, it should include specific provisions in its contracts that require contractors to comply with state laws, regulations, and policies related to reimbursable expenses. In addition, it should include specific performance standards in its contracts and monitor whether the contractors are meeting those standards. Finally, the CPUC should include provisions in its contracts that will allow it to collect damages from nonperforming contractors.

DDTP and CPUC Action: Partial corrective action taken.

Assembly Bill 1734, signed into law on June 20, 2002, authorized the CPUC to enter into contract(s) for the provision of the DDTP services. The CPUC reported that it conducted a competitive bidding process to contract for the personnel to operate the DDTP. The CPUC reported that its competitive bidding process and subsequent contract adhered to all required state contracting rules including requirements related to reimbursable expenses. According to

the CPUC, its contract with the CCAF includes performance measures to be met by CCAF and penalties for noncompliance. The CPUC also stated that it holds all contracts providing services or goods for the DDTP. Program contracts that existed prior to July 1, 2003, have been or are currently being transitioned to state contracts. The transition of these contracts includes submission for review and approval by DGS. The CPUC said that all future program contracts will also be submitted for DGS review and approval.

PUBLIC UTILITIES COMMISSION

Investigations of Improper Activities by State Employees, February 2003 Through June 2003

ALLEGATION I2002-753 (REPORT NUMBER I2003-2), SEPTEMBER 2003

Public Utilities Commission response as of September 2003

Investigative Highlights . . .

A supervisor with the Public Utilities Commission (PUC):

- ☑ *Improperly deposited into his personal bank account $80,759 he received from PUC-sponsored conferences he oversaw during 1999, 2000, and 2001.*
- ☑ *Achieved a profit of $37,542 after paying conference expenses.*
- ☑ *Used $1,408 in funds he received during the 1999 conference to pay for alcohol.*

We investigated and substantiated that a supervisor with the Public Utilities Commission (PUC) improperly deposited into his personal bank account funds he received from the annual state railroad conference (conference) he oversaw.

Finding #1: The supervisor improperly deposited conference funds into his personal bank account.

In violation of state law, the supervisor improperly deposited into his personal bank account at least $80,759 he received as a result of his involvement with the conference. Specifically, between June and August 1999, he deposited $30,056 in checks he received from various individuals or groups of individuals who attended that year's conference. Between May and August 2000, the supervisor deposited into his personal account $8,835, representing a $95 registration fee for as many as 93 individuals. The following year, between July and October 2001, the supervisor deposited $41,868 in his personal account, most of which related to $200 registration fees for more than 130 attendees.

The supervisor maintained that the conference was not a state-sponsored function but rather a joint effort involving various representatives from government, railroad companies, and consulting firms. He reasoned that the State paid only for registration and per diem costs for state-employed attendees and that no one, including his supervisors, indicated that he was handling conference funds inappropriately. Nonetheless, the decision to manage these funds outside the State Treasury is not consistent with state law. The law characterizes funds as public

funds when employees receive them in their official capacity. Documentation such as conference announcements, registration forms, hotel contracts, and check copies clearly demonstrate that these events were advertised as a state conference that the PUC endorsed and that the supervisor acted in his official capacity with the State when he accepted payments related to the conference.

Finding #2: The supervisor profited from his involvement with the state conference.

Because the PUC allowed the supervisor to control conference funds outside of approved state accounts, he was able to retain as much as $37,542 in profits. State law prohibits state employees from engaging in any employment, activity, or enterprise that is clearly inconsistent, incompatible, in conflict with, or inimical to their duties as state officers or employees. Incompatible activities include using state time, facilities, equipment, supplies, and the prestige or influence of the State for one's own private gain or advantage. Our analysis indicates that the supervisor profited by at least $3,725 from the 1999 conference; $3,386 from the 2000 conference; and $30,431 from the 2001 conference.

We asked the supervisor to review our calculations and provide any additional evidence, particularly concerning any conference-related costs that might demonstrate he had not profited from these events. The supervisor insisted that he had lost money each year on the conference and that he had maintained detailed accounting records that proved this until one of his superiors told him that he no longer needed to keep them. After reviewing the accounting records and invoices we obtained from each of the facilities that hosted the conferences, the supervisor stated that he had paid other costs, such as off-site dinners and mailing expenses, that these bills did not reflect. However, he was unable to provide documentation to support any of these additional costs.

Finding #3: The supervisor used funds to pay for alcohol-related expenses.

Of the money the supervisor received and paid for costs associated with the 1999 conference, we identified $1,408 that pertained to alcohol-related expenses. State law prohibits state officers and employees from using state resources for personal enjoyment, private gain, or personal advantage or for an

outside endeavor not related to state business. As we mentioned previously, because state law characterizes the conference funds the supervisor received and deposited as public money, its use to purchase alcohol constitutes a misuse of public funds.

PUC Action: Partial corrective action taken.

The PUC discontinued the conference and plans to train all staff who may accept money from outside parties on proper record-keeping procedures and fiscal accountability. In addition, the PUC states it does not plan to initiate personnel action against the supervisor until it receives and completes its review of critical documentation.

CALIFORNIA PUBLIC UTILITIES COMMISSION

State Law and Regulations Establish Firm Deadlines for Only a Small Number of Its Proceedings

Audit Highlights . . .

Our review of whether the California Public Utilities Commission (commission) promptly resolves formal and informal proceedings found the following:

- ☑ *Few of the 1,602 formal proceedings the commission initiated between January 1, 2000, and June 30, 2003, were subject to statutory deadlines.*
- ☑ *Commission staff provided various reasons for delays, including that the outcomes of some proceedings were dependent on other decisions or investigations or the proceedings were purposely kept open to take up related issues or to manage them in multiple phases.*
- ☑ *Two factors contributed to delays in processing the more informal advice letters, which the commission uses to approve minor requests from utilities: Some had a lower workload priority and some required formal resolution or investigation.*

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REPORT NUMBER 2003-103, NOVEMBER 2003

California Public Utilities Commission's response as of November 2003

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether the California Public Utilities Commission (commission) promptly completes the various types of administrative proceedings it is responsible for conducting. The audit committee asked that we determine how the commission sets priorities in the water, telecommunications, and energy areas when conducting its various types of administrative proceedings. Additionally, we were asked to review staffing levels to assess whether these levels are adequate for the commission to comply with its statutory mandates regarding administrative proceedings. As part of the assessment, we were to consider other studies that may have been performed related to staffing. Finally, the audit committee requested that we identify any timelines contained in law or regulations for the completion of proceedings. We were asked to select a sample of proceedings that exceeded the timelines yet remain unresolved and another sample that exceeded the timelines but were resolved and determine the reasons for delays.

Finding #1: Some proceedings the commission closed promptly that it later reopened appeared to be delayed.

The commission resolved five of 45 proceedings we reviewed within the statutory deadline or guideline, but because its tracking system does not appropriately reflect the resolution of proceedings that are reopened, these proceedings appeared to have been delayed. The commission's system tracks numerous pieces of information about each proceeding, including the title and type of proceeding, when it was opened and closed, and when it was reopened. However, when the commission

Although the commission cited workload and inadequate staffing as contributing to delays in processing its formal proceedings and advice letters, the lack of a workload tracking system hinders its ability to justify staffing needs.

reopens a proceeding, such as when it considers requests for a rehearing, and then closes the proceeding again, the later closing date replaces the initial one. Because only the later closing date is used in measuring how long the commission took to resolve the proceeding, the commission appears to have required more time than it actually did. When we became aware that the closing dates in the tracking system were not always accurate, we reviewed all 70 of the proceedings that had reopen dates and found that the commission resolved 43 within the original deadlines.

We recommended that the commission modify its tracking system to retain the original closing date as well as record its subsequent closing date for those proceedings it reopens.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission believes that our report fails to contemplate the perhaps significant cost of either enhancing or replacing the tracking system. However, based on discussions with our information technology staff, we do not believe the cost to modify the commission's tracking system to retain the original closing date and subsequent closing date for reopened proceedings would be significant. Further, since the commission acknowledges that it does not know whether the costs to enhance or replace its tracking system would be significant, it should first determine what those costs are. If they are prohibitive, the commission should manually track the original closing dates of all proceedings it reopens.

Finding #2: The commission did not report certain proceedings.

Although the commission tracks and reports to the Legislature whether it has met certain deadlines established in law, it does not report whether it is meeting the 60- and 90-day deadlines for issuing draft decisions. Moreover, it does not adequately track the submission date that would allow it to do so. Specifically, although commission staff provided us with submission dates for rate-setting and quasi-legislative proceedings, two of the 12 submission dates reviewed for accuracy were erroneous. In addition, the commission initially was unable to provide us with submission dates for adjudicatory proceedings. According to

the chief administrative law judge (ALJ), the commission based its decision to report only certain deadlines to the Legislature on its belief that the Legislature is most concerned with the portion of these proceedings involving commissioners' actions; therefore, it tracks and reports whether the commissioners have met the 60-day deadline to approve final decisions. However, because ALJs are most often responsible for meeting the 60- and 90-day deadlines to prepare draft decisions, the commission's decision not to report compliance with these deadlines to the Legislature overlooks the portion of the proceedings subject to these deadlines. Therefore, because state law requires the commission to issue draft decisions within either 60 or 90 days of submission, we believe it is important to accurately track all submission dates in order to monitor compliance with these requirements.

To ensure it is complying with the 60- and 90-day deadlines between submission date and filing a draft decision, we recommended that the commission better track its submission dates and monitor whether it is meeting its deadlines.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

Finding #3: The commission did not prepare a work plan access guide annually as required by law.

Although state law requires that the commission develop, publish, and annually update a work plan access guide (work plan), it did not prepare the work plan for 2000 through 2002. Among other things, state law requires the commission to include within the work plan a description of the scheduled rate-making proceedings and other decisions it may consider during the calendar year, information on how the public and ratepayers can gain access to the commission's rate-making process, and information regarding the specific matters to be decided. Ultimately, the commission did prepare a work plan for 2003 that included its criteria for determining regulatory priorities and a list of the 2003 major proceedings. The commission states in its 2003 work plan that it allocates its staff resources for decision making according to a stated set of priorities established by its president.

To ensure it discloses to the public and the Legislature its process for prioritizing its proceedings, we recommended that the commission continue to annually prepare and publicize a work plan, which includes its criteria for prioritizing formal proceedings, as required by law.

Commission Action: Corrective action taken.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

Finding #4: The commission delayed closing or failed to close advice letters promptly.

Staff promptly reviewed and approved 17 of the telecommunications division's and 10 of the energy division's advice letters, which the commission uses to address minor requests from utilities. However, staff either delayed closing or failed to close these 27 advice letters in the proposal and advice letter (PAL) tracking system. This represents 30 percent of the 90 advice letters we selected for testing. We believe that the high proportion of advice letters in our sample that remain open according to the dates in the PAL tracking system when they are actually closed should be of concern to the commission because it recently began using data recorded in the PAL tracking system to report to the commissioners on the status of advice letters. This type of erroneous data generated by the tracking system could be misleading to the commission and to those to which the commission reports this information.

We recommended that to ensure the information included in the PAL tracking system is accurate for reporting to the commissioners in public meetings on the timeliness of advice letters, the commission should review all advice letters in the system and close those where it is appropriate to do so.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission believes that our report fails to contemplate the perhaps significant cost of either enhancing or replacing the PAL tracking system. However, the commission's response mischaracterized

this issue because our recommendation does not require the commission to enhance or replace the PAL tracking system, but to correct the data generated by it.

Finding #5: The telecommunications division does not adequately maintain and track its advice letters.

The commission's telecommunications division (telecommunications) lacks a filing system that allows it to store advice letters and the supporting documentation for the letters in a central location. Thus, telecommunications had difficulties locating advice letter files and related supporting documents. Specifically, telecommunications staff required several weeks to locate 60 advice letter files we requested and were ultimately unable to locate six of them. We observed in many instances that advice letters were located at an analyst's desk or piled on tables rather than in a central filing area. Telecommunications staff conceded that maintaining and tracking advice letters has been and continues to be a problem.

In an attempt to address its filing problems, telecommunications has initiated a pilot project that allows utilities to submit advice letters and supporting documents in an electronic format. A program manager indicated that telecommunications intends to maintain electronic copies of the advice letter and supporting documents, which he believes will facilitate their storage and tracking. Although this may eventually prove successful, telecommunications still needs to file and track the advice letters and supporting documents of utilities that currently choose not to file electronically in such a way that it is able to accurately and promptly retrieve them.

Finally, as part of its processing, telecommunications requires utilities to submit a summary sheet with their advice letters. Telecommunications uses this summary sheet to track the advice letter's progress by indicating the differing levels of review and approval it has received. However, staff often could not locate the relevant summary sheet or, when found, it was not fully completed.

We recommended that as part of its new electronic filing process, the commission ensure that the telecommunications division creates an effective centralized filing system for those advice letters and supporting documents not submitted in electronic format. Additionally, for purposes of oversight and

external and internal review, the commission should ensure that telecommunications staff consistently complete and retain summary sheets to evidence appropriate approval and review and that telecommunications maintains the summary sheets in its advice letter files.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

Finding #6: The commission lacks a workload tracking system that would allow it to justify its staffing needs.

Although the commission indicated that staffing is a limiting factor in promptly processing its formal proceedings and advice letters, it was unable to provide us with workload analyses to support these contentions. In fact, the Department of Finance (Finance), in various reports and management letters it prepared between February 1998 and February 2003, reported that the commission lacks a workload tracking system that would allow it to justify its staffing needs. In response to a February 2003 management letter, the commission began to revise its workload tracking system to address Finance's concerns; however, it does not anticipate implementing key phases of the new system until the end of 2003 or the beginning of 2004. Thus, during our audit the commission was unable to provide us any staffing analyses that would allow us to determine whether its staffing levels are adequate to promptly process formal proceedings and advice letters.

We recommended that the commission continue to work with Finance on improving its workload tracking system so that it can justify its staffing needs.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission indicated that if we could not perform a quantitative analysis of the commission's staffing levels, then we might have performed some qualitative analysis. The commission further stated that we could have interviewed commission management

to see what activities or projects they believed should be undertaken but are prevented by inadequate staffing levels. Contrary to the commission's response, however, we met with the commission's management staff on several occasions. During these meetings, management staff asserted that workload and inadequate staffing contributed to delays. However, as we stated in our report, while the commission's management staff asserted they were short of staff, they could not provide evidence to support their claims.

CALIFORNIA ENERGY MARKETS

The State's Position Has Improved, Due to Efforts by the Department of Water Resources and Other Factors, but Cost Issues and Legal Challenges Continue

Audit Highlights . . .

The Department of Water Resources (department) has renegotiated 23 power contracts with 14 suppliers to improve the energy delivery, financial, and legal aspects of these contracts. In addition, the investor-owned utilities are once again responsible for purchasing the net short.

- ☑ *The portfolio better fits California's power needs due to changes in energy products and a reduction of forecasted demand.*
- ☑ *Reported contract cost reductions were estimated at $5.5 billion on a nominal basis and based on assumptions at the time of the renegotiations.*
- ☑ *Based on March 2003 market assumptions, replacement power costs, and discounting to present value, the department consultant currently estimates ratepayer savings as $580 million.*
- ☑ *The legal terms and conditions of the restructured contracts significantly improved reliability, but the department remains restricted in its ability to assign contracts.*

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REPORT NUMBER 2002-009 APRIL 2003

Department of Water Resources' response as of November 2003

The California Water Code, Section 80270, requires the Bureau of State Audits to conduct two financial and performance audits of the Department of Water Resources' (department) implementation of the power-purchasing program: the first due by December 31, 2001, and the second due by March 31, 2003. We completed the first required audit on December 20, 2001, and this audit fulfills the requirement for the second audit report. In this audit, we follow up on the department's actions with respect to the recommendations from our 2001 audit. To assist us in forming our conclusions related to the economic issues involved, we retained the services of an energy economics firm to perform various analyses.

Finding #1: With renegotiated contracts and a reduction in forecasted demand, the contracted electricity portfolio better matches California's needs and better tracks changes in fuel costs.

The department has renegotiated the terms and conditions of 23 long-term power contracts with 14 suppliers, representing over one-half of the total value of the portfolio. These renegotiated contracts contribute to the improved fit of the portfolio to the State's forecasted demand by converting significant amounts of nondispatchable power—power that the department was obligated to purchase regardless of the need—to power deliveries the department can use when needed. In addition, the renegotiated portfolio increases power deliveries in Northern California in 2002 and 2003 to meet demand. Further, the department was able to shift some deliveries of power from Southern to Northern California, which reduced the amount of surplus power projected in Southern California. The department also renegotiated for more capacity tied to tolling agreements—

☑ *Even though the investor-owned utilities have resumed purchasing the net short, the department retains substantial responsibilities related to the long-term contracts.*

cost management arrangements that allow the department either to purchase the fuel needed for the power facilities under contract or to tie the fuel cost to the current cost of natural gas. However, most of the improvement in the fit of the power supply to the demand has resulted from significant changes in the demand forecast rather than from significant improvements in the power contracts. These forecast changes include reductions in the demand for power from the investor-owned utilities for a variety of reasons, including the ability of certain electricity customers to buy electricity from alternate suppliers.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio including opportunities to further improve the match of power deliveries from the contracts to California's power needs.

Department Action: Partial corrective action taken.

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and continues to seek opportunities to renegotiate other contracts. The department indicates that the renegotiated contracts have improved the match of power deliveries to the State's needs by reducing the amount of nondispatchable power deliveries.

Finding #2: While the renegotiation efforts will provide some savings to ratepayers, the department's portfolio still remains above market prices.

Throughout the energy crisis, the department and the governor's office reported both the contract costs and the savings in terms of the contract payments to suppliers. Thus, they reported that the estimated reductions in contract costs from the restructuring of the contracts totaled approximately $5.5 billion, which represents approximately 13 percent of the total original contract costs of $42.9 billion. These contract cost reductions were based on information available at the time of the renegotiations and were calculated using a negotiation model that the department used when evaluating the effect of different renegotiation options on the reduction in contract costs.

While this savings estimate reasonably reflects reductions in the nominal cost of the contract portfolio to the department, an alternative analysis would estimate the savings to the utilities'

customers. With consideration of the replacement power costs and using the department's revenue requirement model, a department consultant estimated in March 2003 that the net savings to ratepayers in nominal terms is $1.5 billion. Also, because these savings will occur over the next 20 years, the department consultant estimated that the net present value of the future stream of savings to ratepayers is $580 million. These March 2003 estimates of customer savings are a function of economic, market, and dispatch assumptions used by the department consultant in its modeling and would change if those assumptions changed. Also, the department indicates that its revenue requirement model is not designed to value nonprice benefits resulting from the renegotiation efforts, such as the improved availability and reliability provisions in the contracts. Further, most of these contract cost reductions will result not from reducing the price per megawatt-hour of the power purchased but rather from shortening the length of the contracts or reducing the amount of power to be delivered. However, this reduction of contract length contributed to a department objective to shorten the time that it would have financial or legal responsibility for the contracts and, in the process, permit the utilities to procure energy themselves to meet the additional uncovered net short.

According to the department, the March 2003 estimate of savings to the consumer from the renegotiated contracts as of December 31, 2002, using its revenue requirement model, was made only at our request, and the department would not otherwise have made this calculation. In addition, the amounts are from its consultant's draft report, and had not gone through the department's ordinary standards of review. However, this is the only estimate the department provided to us of the savings to the consumer from the renegotiated portfolio as of December 31, 2002. Further, we observed that these forecasts are consistent with the forecasts prepared by the department consultant in establishing the department's revenue requirements and were also used in support of the revenue bonds that the department issued in October and November 2002.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio, including opportunities to achieve additional cost savings.

Department Action: Partial corrective action taken.

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and continues to seek opportunities to renegotiate other contracts. The three renegotiated contracts have reduced contract costs by approximately $1 billion, in nominal terms. However, when considering the savings to consumers by taking into account the cost to replace the power that was eliminated through contract renegotiations, and by considering that the savings occur over time, the net present value (at 9 percent) of the total savings to customers is $322 million. The customer savings varies between approximately $24 million to $74 million from year to year through 2011, but we estimated the savings at approximately $29 million for 2003. The department's consultant calculated the total contract reductions and customer savings using market conditions at the time the three contracts were renegotiated, which is consistent with the methodology used in our audit report.

Finding #3: The renegotiated contracts improve the reliability and flexibility of the department's energy portfolio, but challenges remain.

Our review of the legal terms and conditions of the restructured contracts indicates that the renegotiations have generally resulted in improved terms over those in the original contracts. For example, we found that the restructured contracts have much stronger guarantees that the sellers will deliver the power promised under the contracts and build the new generation facilities promised in the contracts. As a result, the renegotiated contracts better meet the reliable energy goals of Assembly Bill 1 of the 2001–02 First Extraordinary Session (AB 1X) and thus better ensure the availability of electricity to satisfy consumer demand. These improvements are accomplished through stronger terms and conditions, such as termination rights for the State and penalty provisions when sellers fail to deliver energy or construct new generation facilities as promised under the contract. Changes in the type of energy products purchased under the contracts also increase the reliability of the department's contract portfolio. Both the stronger terms and conditions, and the product changes are likely to provide economic benefits to ratepayers. Another benefit from the renegotiations is that the State has entered into settlement

agreements with suppliers. In most of these settlements, the suppliers agreed to cooperate with the attorney general's energy investigation and to make financial settlements to the State.

While the restructured contracts are better from a legal standpoint, significant risks remain for the department, particularly in the contracts that the State has not renegotiated. An area of continuing concern is the restrictions on the department's ability to assign the contracts to other parties, particularly to the investor-owned utilities. The investor-owned utilities have resumed purchasing the net short and have also assumed the day-to-day management and operation of the contract portfolio. However, the department remains legally and financially responsible for the contracts, until either the investor-owned utilities meet certain credit standards or suppliers decide to release the department from this obligation. As a result, the department continues to have significant ongoing legal and technical responsibilities for the management of the long-term contracts and could retain those responsibilities for the remaining life of the contracts.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio, including opportunities to improve the terms and conditions of contracts that have not yet been renegotiated. In regard to its continuing responsibility to manage the long-term contracts, the department should monitor the performance of power suppliers relative to their contractual obligations and promptly address and resolve any supplier deviations from contractual obligations. We also recommended that the department review the appropriateness of the investor-owned utilities' proposed annual gas supply plans for contracts with tolling agreements.

Department Action: Partial corrective action taken.

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and continues to seek opportunities to renegotiate other contracts. The department reports that three contracts have improved terms and conditions. For example, one contract now includes anti-market gaming provisions and allows the department to assign it to a creditworthy investor-owned utility. Another contract also includes a settlement of claims with the attorney general and other parties, which the department indicates is valued at approximately $1.5 billion.

To ensure that the investor-owned utilities exercise due care in the handling of the contracts, the department indicates that its staff and consultants conduct weekly internal coordination meetings as well as weekly conference calls with the investor-owned utilities. Further, the department and the investor-owned utilities work together to review the gas supply plans related to each of the gas tolling contracts. Additionally, for those contracts that are tied to new power plant construction, the department indicates that its staff and consultants witnessed 32 performance demonstration tests, which are designed to ensure compliance with contract terms either before a power plant begins commercial operation or as an annual performance test of an existing power plant. Finally, the department states that staff periodically visits construction sites for new power plants to ensure that the progress is consistent with the contract.

Finding #4: Sales of surplus power have not significantly affected the cost of the power-purchasing program.

In our December 2001 audit, we indicated that in future years the department's long-term contracts would likely require it to purchase more power than would be needed during some hours. Those quantities would be expected to be sold as surplus and thus have the potential to increase the overall cost of power. In 2002 the department did sell surplus power, but these sales were not significant in proportion to its total purchases. Further, our consultant advises us that the costs from the sales do not appear unreasonable. Although the department's renegotiation efforts have reduced the potential for surplus power sales in future years, it is still likely that significant sales will occur, particularly in the years 2003 through 2005.

To monitor the efforts of investor-owned utilities to limit power sales, the department should routinely collect and analyze data (including settlement data from the California Independent System Operator) on power sales by the investor-owned utilities.

Department Action: Corrective action taken.

The department indicates that it negotiated with the investor-owned utilities and the California Independent System Operator to receive the information needed to allow it to appropriately monitor sales of surplus energy.

Finding #5: The department was not able to achieve coordinated dispatch of power supplies that could reduce costs.

The department was not able to achieve a coordinated dispatch of power supplies between the contract portfolio and the investor-owned utilities' generating facilities so as to minimize costs to ratepayers. The electric power that the retail customers of the investor-owned utilities purchase is obtained from a variety of sources, each with a different cost per unit of power delivered during different times of the day and week. As such, there is an opportunity each day to optimize this mix of sources to provide power at the lowest possible cost. However, the department has been unable to implement a coordinated dispatch of power sources with the investor-owned utilities. It attributes this inability, to some degree, to the investor-owned utilities' failure to share with the department information about the availability of their generating facilities and the terms of their third-party contracts, as well as to fluctuations in demand forecasts by the investor-owned utilities that make minimizing purchase costs more difficult.

Recognizing the California Public Utilities Commission's (CPUC) established role in overseeing the dispatch decisions of the investor-owned utilities, the department should routinely monitor resource scheduling and other data provided by each utility to ensure that dispatch decisions are consistent with established operating protocols and its fiduciary responsibility to bondholders.

Department Action: Corrective action taken.

The department indicates that it currently receives all dispatch information on a daily basis. This information allows the department to compare actual dispatch of contract energy with projected dispatches and to determine whether there will be any significant deviations to the department's cash flow as a result of the investor-owned utilities' dispatch decisions.

Finding #6: The department will continue to face cost and legal challenges.

Substantial work remains to be done by others to restore California's electric markets to full health and to manage the power portfolio assembled by the department during its two-year tenure as power buyer for the State. Issues involving the creditworthiness of the investor-owned utilities must be resolved, plans must be made for the long-term governance of the utilities'

power-procurement practices, and changes are needed in the power market structure to assure that the markets are effective and well monitored. Although California's power supply situation has improved over the past two years, accounting and credit issues have affected many companies in the power supply industry, raising questions regarding the further development of new supplies. Furthermore, substantial outstanding investigations and litigation associated with the power crisis are still unresolved. In addition to marketwide issues, the department's ongoing stewardship of the Electric Power Fund and the contract portfolio will be an important component of the State's power supply for years to come. The contract portfolio is likely to remain under department management for much of the next decade and will require continued vigilance to mitigate the potentially high costs of those contracts. Attendant upon those responsibilities will be the need for the department to manage its operating partnerships with the utilities to schedule and deliver the power and to procure fuel. In addition, the department will be responsible for the administration of bonds issued to finance the cost of the AB 1X power program. These remaining responsibilities carry substantial ongoing obligations to manage costs and risks and will require a sustained professional organization at the department to properly protect the State's interests.

We recommended that the department be alert for situations in which the credit standing of the investor-owned utilities may adversely affect the department's costs. Further, the department needs to maintain the capability to analyze conditions in electricity and gas markets. The department should also use the servicing agreements with the investor-owned utilities to monitor dispatch statements from the investor-owned utilities relative to their accounting statements to the department. Finally, to fulfill its responsibilities for servicing the revenue bonds, the department should prepare revenue requirements filings for the CPUC and advise the CPUC when its regulatory oversight of the investor-owned utilities intersects with the department's responsibilities under the revenue bonds; act to mitigate risks, such as CPUC ratemaking practices, that may adversely affect bondholders; and perform financial and accounting activities necessary to support its obligations under the revenue bonds.

Department Action: Partial corrective action taken.

The department reports a variety of actions to address our recommendations. In regards to the credit standing of investor-owned utilities, the department notes that because gas suppliers are unwilling to extend sufficient credit to the investor-owned utilities, the department is the principal counterparty for all fuel purchasing, storage, transportation, and hedging contracts. Concerning the need to maintain capabilities to analyze conditions in the electricity and gas markets, the department subscribes to various gas and power market information services, which it uses to analyze the reasonableness of the investor-owned utilities' actions. Additionally, the department actively follows and monitors CPUC proceedings that may impact or change the operating agreements with the investor-owned utilities and that might be adverse to the department or its responsibilities under AB 1X. When such issues are identified, the department files memoranda or comments in these proceedings to preserve its rights and explain its position to the CPUC. Further, the department believes the implementation of several automated tools has allowed it to make progress in monitoring dispatch statements from the investor-owned utilities, but it indicates that some problem areas need further attention. Finally, the department indicates that it continues to prepare the annual revenue requirement for the CPUC and to perform the financial and accounting activities to support the department's obligations under the revenue bonds.