Implementation of State Auditor's Recommendations

Audits Released in January 2005 Through December 2006

Special Report to

Assembly Budget Subcommittee #4—State Administration

February 2007
Report No. 2007-406 A4

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CALIFORNIA STATE AUDITOR

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February 28, 2007 2007-406 A4

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 Assembly Budget Subcommittee No. 4—State Administration. 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. 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

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INTRODUCTION

This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2005 through December 2006, that relate to agencies and departments under the purview of the Assembly Budget Subcommittee No. 4—State Administration. 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 the auditee provides 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 January 2007.

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DEPARTMENT OF CORRECTIONS AND REHABILITATION

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATION I2005-0781 (REPORT I2006-1), NOVEMBER 2006

Department of Corrections and Rehabilitation's response as of November 2006

Investigative Highlights . . .

Department of Corrections and Rehabilitation:

- ☑ *Allowed nine exempt employees to improperly accrue 516 hours of holiday credits, resulting in gifts of public funds of $17,164.*
- ☑ *Allowed the same nine exempt employees to work alternate work schedules resulting in 1,460 hours of leave that did not have to be charged and gifts of public funds totaling $49,094.*

We investigated and substantiated an allegation that the Department of Corrections and Rehabilitation (Corrections) failed to exercise its management controls, resulting in gifts of public funds at the Sierra Conservation Center (center).

Finding #1: Corrections improperly allowed center employees to accrue holiday credits when these employees were not required to work.

Contrary to the terms in the collective bargaining agreement, when a holiday fell on a scheduled day off, the center allowed exempt employees represented by the American Federation of State, County, and Municipal Employees (Union A) to accrue holiday credits for later use, even though they had not worked.

The current collective bargaining agreement between the State and Union A (Union A agreement), which is effective through July 1, 2006, specifically states that exempt employees accrue holiday credits when they are required to work on holidays.

The center improperly allowed nine exempt Union A employees to accrue 516 hours, resulting in gifts of public funds totaling $17,164 between January 2002 and May 2005.

➲ ***Corrections' Action: None.***

Finding #2: Center employees do not charge leave credits to account for their full workday.

The collective bargaining agreement for Union A requires exempt employees to post leave only in eight-hour increments (or their fractional equivalent depending on their time bases) for each full day of work missed. At the same time, the center allowed nine exempt employees to work alternate work schedules consisting of 10-hour days.

The Union A agreement specifies that exempt employees can charge leave balances only in increments of eight hours, regardless of actual hours worked each day when leave credits are charged. It also requires the State to reasonably consider employees' requests to work alternate schedules. Alternate work schedules include, but are not limited to, working four 10-hour days in one week. The center allows both full- and part-time exempt employees represented by Union A to work alternate schedules. For example, a full-time employee can work four 10-hour days, a three-quarter-time employee can work three 10-hour days, and a half-time employee can work two 10-hour days to perform the requisite number of work hours in one week.

This presents a problem when these employees take a day off, because the center charges only eight hours against their leave balances for each day they are absent, although they are missing 10 hours of work per day. Overall, the center did not charge 1,460 hours to the leave balances of Union A employees who work alternate work schedules, resulting in a gift of public funds for $49,094.

➲ ***Corrections' Action: None.***

VICTIM COMPENSATION AND GOVERNMENT CLAIMS BOARD AND DEPARTMENT OF CORRECTIONS AND REHABILITATION

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATIONS I2004-0983 AND I2005-1013 (REPORT I2006-1), MARCH 2006

Victim Compensation and Government Claims Board and Department of Corrections and Rehabilitation's responses as of November 2006

Investigative Highlight . . .

Victim Compensation and Government Claims Board and Department of Corrections and Rehabilitation made duplicate payments to an employee of nearly $26,000.

We investigated and substantiated an allegation that the Victim Compensation and Government Claims Board (Board) improperly awarded payments to a physician at the California Department of Corrections and Rehabilitation (Corrections).

Finding: The Board and Corrections made duplicate payments on the physician's claims.

In January 2000 Corrections began paying a $2,700 per month recruitment and retention bonus to Corrections' employees in the classification of chief psychiatrist (psychiatrist bonus). Between October 2000 and May 2002 a physician employed by Corrections filed multiple claims with both Corrections and the Board, stating that he was entitled to the psychiatrist bonus because he claimed he regularly devoted a portion of his work time to psychiatry. The physician received payments from both the Board and Corrections for essentially the same claim and ultimately received at least $25,950 more than he was entitled to because of the duplicate payments. Further, although the Board and Corrections were aware that the physician was about to receive state funds to which he was not entitled before receiving his final payment and the physician himself directed the Board to reduce his claim on three separate occasions, neither entity adjusted the physician's final claim nor recovered the overpayment.

When the Board considered the physician's claims and made a determination regarding the amount to which he was entitled, the Board may have exceeded its legal authority, and violated its own policy. Moreover, when the Board paid the physician's claims, it relied on legal authority that allows it to order the payment of a claim "for

which no appropriation has been made." It relied on this legal authority despite the fact that the department that had been ordered to pay this claim by the Department of Personnel Administration (DPA) did, in fact, have an appropriation of funds sufficient to satisfy this claim, and the Board was made aware of this fact before making the duplicate payments. Further, the Board reviewed this claim and determined the amount to which the physician was entitled in disregard of the advice of its own staff and notices from DPA that the Board lacked legal authority in this case.

It is well established that DPA is the state agency that has full authority related to the salaries and other entitlements, such as the retention bonus at issue here, of state employees. Further, Board staff recommended that it reject the claim for lack of authority to order Corrections to reclassify the physician's position. However, Board members are not required to follow the recommendations of involved departments or its own staff and Board policy directs its staff to allow all claims against state agencies to be heard by the Board, regardless of whether the claim falls within the Board's statutory authority.

Board's Action: Partial corrective action taken.

The Board reported that it believes it had jurisdiction to hear the physician's claims and again stated it did so under state law that allows the Board to hear claims when no statute or constitutional provision provides for a settlement. However, as previously mentioned, the fact that the physician also filed a grievance for essentially the same claim with Corrections and was awarded relief for that claim, clearly demonstrates that statutory relief was available in this case. Moreover, funds were readily available to pay this claim and the Board was informed of this fact prior to its payment of the physician's claim.

The Board also reported that it has implemented changes that will prevent it from making overpayments in the future; however, these reported changes do not address the issue of the Board's practice of allowing all claims against state agencies to be heard by the Board, regardless of whether there is other statutory relief available. Consequently, it appears that the Board still lacks the controls necessary to prevent it from hearing claims over which it lacks authority and possibly awarding additional duplicate payments in the future.

Corrections' Action: Partial corrective action taken.

After we informed Corrections of the overpayment, it initiated action to attempt to recover the $25,950 overpayment from the physician. As of the date of this report, Corrections reported it has recovered $2,000 from the physician and is in the process of requiring him to reimburse the State approximately $2,700 per month—the maximum amount allowed by law—until the total overpayment is collected.

Corrections reported it could not pursue collecting the overpayment through payroll deductions because the overpayment was not a *payroll* overpayment. Corrections added that the physician is voluntarily making payments to the State; however, it was unable to tell us how much the physician is paying monthly or how much he has paid to this point.

DEPARTMENT OF FISH AND GAME

Investigations of Improper Activities by State Employees, July 2005 Through December 2005

INVESTIGATION I2004-1057 (REPORT I2006-1), MARCH 2006

Department of Fish and Game's response as of February 2006

Investigative Highlights . . .

The Department of Fish and Game:

- ☑ *Provided gifts of free rent of more than $87,000 to employees and volunteers.*
- ☑ *Failed to report housing fringe benefits totaling almost $3.5 million over a four-year period.*
- ☑ *Deprived state and federal taxing authorities of as much as $1.3 million in potential tax revenues for tax years 2002 through 2005.*

Other state departments:

- ☑ *May have failed to report housing fringe benefits of as much as $7.7 million.*
- ☑ *May have failed to capture as much as $8.3 million in potential rental revenue.*

We investigated and substantiated the allegation, as well as other improper acts. The Department of Fish and Game (Fish and Game) allowed several state employees and volunteers to reside in state-owned homes without charging them rent. Consequently, Fish and Game violated the state law prohibiting state officials from providing gifts of public funds.

Finding #1: Fish and Game provided free housing to employees and volunteers and failed to report housing fringe benefits.

Fish and Game allowed several state employees and volunteers to reside in state-owned homes without charging them rent. Consequently, Fish and Game violated the state law prohibiting state officials from providing gifts of public funds. We identified seven volunteers and six employees who resided in state-owned homes in Fish and Game's North Coast Region but were not required to pay rent for a total of 718 months between January 1984 and December 2005. Because Fish and Game provided free rent to some employees and volunteers, the State did not receive more than $87,000 in rental revenue to which it was entitled between January 1984 and December 2005.[1] Therefore, that amount represents a gift of state funds to the employees and volunteers residing in the state-owned homes and a loss in revenue to the State. State regulations provide that departments shall review the monthly rental and utility rates of state-owned housing every year and report those rates to the Department of Personnel Administration (DPA).

Based on a review of state-owned housing conducted by DPA, as well as on information provided by the departments to DPA, it appears that Fish and Game understated its employees' wages by more than $867,000 each year from 2002 through 2005 because it did not report any fringe benefits for its employees who reside on state property at below-market rates. As a result, over the four-year period, state and federal tax authorities were unaware of the potential $1.3 million in taxes associated with a total of nearly $3.5 million in potential housing fringe benefits.

[1] This conservative amount is based on the nominal rents Fish and Game charges when it requires its employees to pay rent. However, if fair market value, as determined by the Department of Personnel Administration, were applied to the 718 months of free rent, this figure could be greater.

Fish and Game's Action: None.

➔ Fish and Game reported that it disagrees with the amount we show as being reportable housing fringe benefits and the associated potential tax revenues. Specifically, Fish and Game believes our report overstates the alleged taxable fringe benefits and associated potential tax revenues because it has determined that a majority of its resident employees meet the condition-of-employment test, and that the fair market values used in the DPA review do not accurately reflect the values of its properties.[2]

Based on our review of applicable tax law and the records we reviewed at Fish and Game's North Coast Region, we determined Fish and Game did not properly document and demonstrate that a majority of its employees met the condition-of-employment test. Further, although we acknowledge that the fair market values used in DPA's review may not reflect the actual value of all department holdings, DPA was unable to use actual fair market values because Fish and Game failed to determine and report to DPA the fair market value rates for any of its properties—rates it also needed to fulfill its responsibility to accurately report the housing fringe benefits realized by its employees. Fish and Game also reported that current budget constraints prohibit it from obtaining appraisals to determine the most accurate fair market values, but that it is considering requesting funding to do so. However, Fish and Game charges its employees rent at less than 25 percent of the fair market rates used by DPA. If current appraisals were to value the properties at half the values used by DPA, and if it were to raise rental rates to those fair market values, it appears that Fish and Game could recover the cost of such appraisals within one or two months.

In addition, Fish and Game reported that it disagrees with our conclusion that certain personnel received gifts of state funds because our report incorrectly presumes that Fish and Game is obligated to charge fair market rates for all of its housing and it is Fish and Game's understanding that rental rates are fixed and limited by state law, regulations, and employee collective bargaining agreements.

Our conclusion in the report that Fish and Game provided gifts of state funds of over $87,000 to specific personnel is not based on a comparison to fair market values as Fish and Game asserts. Rather, the amount we report is based on a comparison of free rent, versus the nominal rate Fish and Game charges when it requires its employees to pay rent, which appears to be well below fair market value. Additionally, we disagree with Fish and Game's assertion that rental rates are fixed by state law, regulations, and employee collective bargaining agreements. DPA is the agency responsible for administering state housing regulations, and state law provides that the director of DPA shall determine the fair and reasonable value of state housing. Using information reported by Fish and Game for DPA's 2003 survey, DPA directed Fish and Game to raise rental rates to fair market value and acknowledged that it should do so in accordance with employee collective bargaining agreements, which allow Fish and Game to raise rental rates by 25 percent annually. Additionally, our review of records in the North Coast Region found that Fish and Game has in fact adjusted the amount of rent it charges residents on numerous occasions in the past, thus demonstrating that the rates it charges its residents are not "fixed."

Finally, Fish and Game reported that it has been working with DPA for several years as part of its commitment to ensure that it is in compliance with laws and regulations applicable to its properties and is committed to continuing to do so. Fish and Game added that part of this commitment included providing updated information regarding housing-related reporting and withholding requirements to its employees and administrative personnel in July 2002 and again in August 2003. However, as we previously mentioned, Fish and Game has not reported a state-housing fringe benefit for any of its employees since 2001 and it appears it is not in compliance with IRS regulations governing reportable housing fringe benefits despite Fish and Game's assertion that it is committed to doing so.

[2] The difference between the fair market value and the rental amount paid by the resident represents a taxable fringe benefit to the resident unless residing on state property is a condition of employment. To meet the conditions of employment test, Internal Revenue Service guidelines provide that the employee's residence must be the same place in which he or she conducts a significant portion of his or her workday. The guidelines add that the employee must be required to accept on-site lodgings to perform their duties because the housing is indispensable to the proper discharge of their assigned duties.

Finding #2: Other state departments have also failed to report housing fringe benefits.

Although we focus on Fish and Game's management of state-owned housing in this report, the housing review conducted by DPA shows that all 13 state departments that own employee housing may be underreporting or failing to report housing fringe benefits. For example, the Table shows that in 2003 state departments may have failed to report housing fringe benefits totaling as much as $7.7 million, depriving state and federal tax authorities of as much as $3 million annually in potential tax revenues. Additionally, because state departments have chosen to charge employees rent that is well below market rates, the State may have lost as much as $8.3 million in potential rental revenue in that year.[3]

TABLE

Potential Income and Benefits Related to Rental Housing Units Held by State Departments, 2003

Department	Rental Units	Annual Income If Rented at Fair Market Value (FMV)	Annual Rent Charged	Lost State Revenue (Difference Between FMV and Rent Charged)*	Taxable Fringe Benefit Reported	Unreported Taxable Fringe Benefits†
Department of Parks and Recreation	487	$ 4,778,496	$ 763,488	$4,015,008	$373,198	$3,641,810
Department of Corrections and Rehabilitation	176	2,139,972	909,732	1,230,240	0	1,230,240
Department of Developmental Services	99	1,254,360	309,240	945,120	5,728	939,392
Department of Fish and Game	168	1,124,532	257,316	867,216	0	867,216
Department of Forestry and Fire Protection	72	559,332	218,400	340,932	53,078	287,854
Department of Mental Health	40	366,720	125,472	241,248	34,031	207,217
Division of Juvenile Justice	51	371,760	136,740	235,020	69,152	165,868
Department of Transportation	42	294,984	144,324	150,660	17,300	133,360
Department of Veterans Affairs	22	235,224	97,512	137,712	9,240	128,472
Santa Monica Mountains Conservancy‡	9	82,512	0	82,512	0	82,512
California Highway Patrol	6	41,184	12,732	28,452	0	28,452
Department of Food and Agriculture	5	29,18	5,844	23,340	0	23,340
California Conservation Corps	4	36,888	20,748	16,140	3,058	13,082
Totals	**1,181**	**$11,315,148**	**$3,001,548**	**$8,313,600**	**$564,785**	**$7,748,815**

Source: 2003 Department of Personnel Administration Departmental Housing Survey.

* This amount represents what should have been reported to taxing authorities as a taxable fringe benefit.

† Taxable housing fringe benefits exist when the rental rate charged is less than the fair market rate. Thus, no taxable fringe benefit exists when employees pay fair market rates.

‡ No rent was charged for any department properties.

[3] Taxable fringe benefits exist when the rental rate charged is less than the fair market rate. Thus, no fringe benefit exists when employees pay fair market rates.

Department of Parks and Recreation's Action: None.

➔ The Department of Parks and Recreation (Parks and Recreation) believes that the state regulations relevant to state-owned housing for employees not represented by collective bargaining agreements (non-represented employees) do not allow it to raise rental rates beyond those listed in the regulations and stated that non-represented employees reside in approximately one-third of its properties. However, after reviewing the information Parks and Recreation submitted to DPA, it appears that non-represented employees reside in less than one-tenth of its inhabited properties. Regardless, Parks and Recreation believes that in order for it to raise rental rates for its non-represented employees and not violate state regulations, DPA must update the rates listed in state regulations. Parks and Recreation added that many of the collective bargaining agreements, under which most of its remaining employee residents work, limit its ability to raise rental rates. However, DPA, the agency responsible for administering state housing regulations, has specifically given Parks and Recreation direction to raise rental rates to fair market value and acknowledges that it should do so in accordance with employee collective bargaining agreements. These agreements generally allow Parks and Recreation to raise rental rates by 25 percent annually up to fair market value. After receiving this direction, Parks and Recreation responded to DPA, requesting that DPA provide clear authority and policy direction to departments, and inform employee unions of this direction; however, DPA has not responded to this request.

Parks and Recreation also reported that it believes the fair market values used in DPA's review do not fairly represent the true value of its homes. We acknowledge that the fair market values used in DPA's review may not reflect the actual value of all department holdings; however, DPA was unable to use the actual fair market values because Parks and Recreation failed to determine and report to DPA accurate fair market value rates for all of its properties—rates it also needed to fulfill its responsibility to accurately report the housing fringe benefits realized by its employees. After reviewing the information it submitted to DPA, it appears that it provided fair market determinations for only 298 of the 817 properties it owns. Moreover, Parks and Recreation failed to indicate when the last appraisal was conducted for all but 90 of the 298 properties and had conducted appraisals on only 14 of those properties in the previous 10 years, thus demonstrating that it did not report accurate, up-to-date fair market rates to DPA.

Parks and Recreation also takes issue with the amounts identified by DPA as losses in state revenue and underreported fringe benefits because many of its employees live on state property as a condition of employment and therefore, there is no loss in rental revenue to the State or fringe benefit to report. However, after reviewing the information provided to DPA, it appears that Parks and Recreation did not clearly indicate which, if any, of its residents resided on state property as a condition of employment. Specifically, even though the survey guidelines instructed Parks and Recreation to indicate the reason for occupancy for each of its properties, it did not list as a reason condition of employment for any of its properties.

Department of Corrections and Rehabilitation's Action: Pending.

The Department of Corrections and Rehabilitation (Corrections) reported that it last established fair market value rates for all its properties in 1999 and that it subsequently raised rents to the 1999 fair market value rates for properties at all but one of its institutions. Corrections added that it has since raised rates at the remaining institution and is committed to hiring a consultant within six months to begin obtaining current fair market value appraisals.

Corrections reported that it attempted to obtain the services of a consultant to perform fair market appraisals for its properties through the state procurement process; however, Corrections decided not to contract with the lone responsive bidder because it believes that the consultant's fees were too high. Corrections added that it plans to use housing appraisal services through a master services agreement initiated by DPA that is projected to be in place in April 2007.

Department of Developmental Services' Action: Pending.

The Department of Developmental Services (Developmental Services) reported that it believes the fair market rates used by DPA do not accurately reflect the true value of its properties because many of its units are single rooms without kitchens and in some cases residents share bathrooms. We acknowledge that the fair market rates used in the DPA review may not reflect the actual value of all department holdings; however, DPA was unable to use the actual fair market rates because Developmental Services failed to determine and report to DPA the fair market value rates for any of its properties—rates it also needed to fulfill its responsibility to accurately report the housing fringe benefits realized by its employees.

Developmental Services also reported that it has initiated steps to obtain fair market appraisals for all its properties and will follow provisions in applicable collective bargaining agreements to increase rental rates commensurate with the fair market appraisals once they are established.

Department of Forestry and Fire Protection's Action: Partial corrective action taken.

The Department of Forestry and Fire Protection (Forestry) reported that it has taken several steps to resolve state housing issues since it reported information to DPA for its review in 2003. Specifically, Forestry reported that it now reviews rental rates each year and rents that are below fair market value will be raised by 25 percent annually in accordance with applicable collective bargaining agreements. It also reported that it currently reports taxable fringe benefits for residents in Forestry housing on a monthly basis. In addition, Forestry reported that the fair market rates used by DPA do not accurately reflect the true values of its properties because most are located within the boundaries of conservation camps primarily occupied by prison inmates; however, it acknowledged that annual appraisals are necessary to document the accurate value of each unit. Finally, due to increased rental rates and additional vacancies, Forestry reported that the difference between fair market value and actual rental income for all of its properties in 2005 was $32,805 and that by increasing rents 25 percent each year, the difference will continue to decline.

Department of Mental Health's Action: Partial corrective action taken.

The Department of Mental Health (Mental Health) reported that it believes the fair market rates used in DPA's review do not accurately represent the values of its properties but acknowledged that many, if not all, of its state hospitals have been using outdated fair market values. Mental Health also reported that it will update its special order concerning employee housing to include performing annual fair market value determinations and promptly reporting housing fringe benefits. The special order will be distributed to each of its four state hospitals and Mental Health will monitor the hospitals for ongoing compliance. Mental Health added that for certain purposes, such as the recruitment and retention of interns, its state hospitals charge less than fair market value and in these instances Mental Health will ensure that the hospitals report the housing fringe benefits in accordance with state and federal regulations.

Division of Juvenile Justice's Action: None.

The Division of Juvenile Justice reported that it last obtained fair market value appraisals for all of its properties in 1995 and that it subsequently raised rental rates to the 1995 fair market value rates.

Department of Transportation's Action: Corrective action taken.

The Department of Transportation (Caltrans) reported that it believes the fair market rates used by DPA do not accurately reflect the true value of its properties because all of its properties are located in remote areas situated within Caltrans maintenance facilities. Caltrans also reported that its policies require that it charge fair market value for all employee housing and that it update fair market values annually; however, Caltrans was unable to explain why it did not report fair market values to DPA. Although we did not validate its analysis, Caltrans reported that based on its most recent fair market value determinations, the loss of state revenue in 2003 was only $19,356 and the amount of underreported fringe benefits was much less than what DPA identified in its review.

Department of Veterans Affairs' Action: Corrective action taken.

The Department of Veterans Affairs (Veterans Affairs) reported that it conducted fair market assessments of its properties in September 2005 and that it submitted its corrected housing information to DPA in October 2005. Veterans Affairs also reported that it established new rental rates based on the assessments and informed its residents that the new rates would take effect March 1, 2006.

Santa Monica Mountains Conservancy's Action: Corrective action taken.

The Santa Monica Mountains Conservancy reported that it has only six employees, none of whom live on state property. It added that in lieu of rent, it currently allows non-state employees to reside on eight of its properties to provide and ensure resource protection, site management, facilities security and maintenance, and park visitor services.

California Highway Patrol's Action: Partial corrective action taken.

The California Highway Patrol (Highway Patrol) reported that it determines rental rates in accordance with applicable state regulations and that because all of its employees reside on state property as a condition of employment, it has not underreported housing fringe benefits. The Highway Patrol added that it is in the process of obtaining appraisal reviews for its properties and is updating its policies and procedures to reflect that assignments to its resident posts are classified as "condition of employment."

Department of Food and Agriculture's Action: Corrective action taken.

The Department of Food and Agriculture (Food and Agriculture) reported that its employees currently reside on two state properties as a condition of employment. As a result, there is no fringe benefit to report for those residents. Food and Agriculture added that because these properties are located near popular resort areas, fair market values are not comparable to values of homes in surrounding communities.

California Conservation Corps' Action: Pending.

The California Conservation Corps (Conservation) reported that it will be conducting new appraisals to determine updated fair market values for its properties and that rental rates will be increased to the extent allowed by law and applicable collective bargaining units. Conservation also stated it would report on the fringe benefit amount—the difference between the rent charged and the fair market value determined by these new appraisals—for employees residing on its properties, and has informed affected employees of this fact.

CALIFORNIA DEPARTMENT OF CORRECTIONS AND REHABILITATION

The Intermediate Sanction Programs Lacked Performance Benchmarks and Were Plagued With Implementation Problems

Audit Highlights . . .

Our review of the California Department of Corrections and Rehabilitation's (department) intermediate sanction programs for parole violators revealed the following:

- ☑ *Although the department had data regarding parole violators in the programs, it did not analyze the data or establish benchmarks that it could measure the programs' results against.*
- ☑ *The department's savings were substantially less than anticipated because its savings estimates were based on unrealistic expectations and the programs were implemented late.*
- ☑ *To minimize the risk to public safety, less dangerous parole violators were placed in the intermediate sanction programs; however, a small percentage of parole violators were convicted of new crimes during the time they otherwise would have been in prison.*
- ☑ *Although implementation of the intermediate sanction programs was planned for January 1, 2004, the implementation was delayed due to labor negotiations, a department leadership change, and unanticipated contracting problems.*

REPORT NUMBER 2005-111, NOVEMBER 2005

California Department of Corrections and Rehabilitation's response as of November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review how the California Department of Corrections and Rehabilitation (department) handles parole violators under its New Parole Model policy. Specifically, the audit committee requested that we assess the steps used and the extent to which the department has implemented and monitored its new parole policy, focusing on the intermediate sanction programs, including electronic monitoring, substance abuse treatment control units, and community detention houses. In addition, the audit committee asked us to determine whether the department had established performance measures to measure the efficacy of its parole policy in lowering the recidivism rate.

On April 11, 2005, shortly after the audit committee approved the audit, the department secretary terminated the department's use of the intermediate sanction programs as an alternative to parole revocation and return to prison. The programs we were asked to audit had been operating for 14 months or less when they were canceled, so the data available for our analysis were limited.

Finding #1: The department could have established benchmarks and evaluated the intermediate sanction programs against them, but did not.

Although the department's Division of Adult Parole Operations (parole division) had gathered data about the intermediate sanction programs, it did not analyze the data to evaluate the programs' impact on public safety. In addition, the parole division did not establish benchmarks, such as acceptable return to custody rates for participants that it could measure the program against. Monitoring the programs' impact on public safety against established benchmarks would have provided

information relevant to the secretary's decision to terminate the programs, such as whether the percentages of parolees in the programs who were convicted of new crimes or who committed parole violations when they otherwise would have been in prison were within acceptable limits. In addition, had the parole division established benchmarks for what it considered success, such as a minimum number of parole violators completing the programs, and analyzed the available data—similar to what we did for our report—the secretary could have used the analyses in deciding whether terminating the intermediate sanction programs was the best choice. Finally, by defining benchmarks before implementing the programs, the parole division could have determined whether it needed additional data to measure against the established benchmarks.

We recommended when planning future intermediate sanction programs, that the parole division decide on appropriate benchmarks for monitoring performance, identify the data it will need to measure performance against those benchmarks, and ensure that reliable data collection mechanisms are in place before a program is implemented. After implementing a new intermediate sanction program, the parole division should analyze the data it has collected and, if relevant, use the data in its existing databases to monitor and evaluate the program's effectiveness on an ongoing basis.

Department's Action: Partial corrective action taken.

The parole division indicates it has established specific benchmarks for the outcomes that it expects to achieve for each of its seven parole programs and it is also beginning to review these benchmarks against the cost effectiveness of the programs. In the future, after it believes that participation levels in the programs are stable, the parole division states that it will develop additional benchmarks to measure the performance of the seven parole programs, such as program referrals, enrollments, occupancy rates, hours of capacity, and program placement. The parole division also states that it has designed a database to record this information and that program goals and actual numbers were posted on the parole division's internal Web site for management and staff to review. Finally, it states that the department's office of research completed a performance review of the parole programs in October 2006 to assess the reasonableness of the outcome goals.

Finding #2: Late implementation and unrealistic expectations prevented the intermediate sanction programs from achieving desired savings.

For various reasons, none of the intermediate sanction programs were implemented by January 1, 2004, as planned, so parole violators could not be placed in the programs as early as had been intended. Compounding the delayed implementation was the parole division's unrealistic expectation that the programs would be fully occupied by the first date of implementation. The parole division also did not take into account that there would be a ramping-up period during which occupancy in the programs would increase gradually, but instead, assumed full capacity from the beginning.

The parole division did not evaluate the data it had about the Halfway Back and Substance Abuse Treatment Control Units (SATCU) programs, so it was unable to calculate the savings achieved by the programs. It was apparent, however, that the savings were substantially less than anticipated because of the delays in implementing the programs and placing parole violators in them. Using the parole division's estimates and data about the programs and the participants, we estimated that for the 5,742 parole violators placed in the programs by December 31, 2004—2,567 in the

SATCU program and 3,175 in the Halfway Back program—the department saved $14.5 million—$7.4 million and $7.1 million, respectively. The savings equates to an average $1.2 million per month over a 12-month period, far short of the average $8.4 million per month it would have had to save to achieve its planned savings of $50.2 million for fiscal year 2003–04 and $100.5 million for fiscal year 2004–05.

We recommended that the parole division ensure the savings estimates developed during program planning are based on reasonable assumptions, and if those assumptions change, update the savings estimates promptly.

Department's Action: Corrective action taken.

The parole division concurs with our recommendation and indicates it will ensure that any discussions with legislative staff or other researchers include reasonable projections or estimates, and that it updates and reassesses projected savings in a timely manner. Specifically, when developing its fiscal year 2006-07 budget, the parole division indicates adjusting the assumptions and savings estimates related to its parole programs based on current data.

Finding #3: The parole division could have established a performance baseline and used it to analyze the effect the intermediate sanction programs had on parolee behavior, but did not.

The parole division hoped that parole violators would benefit from services they received while in the SATCU and Halfway Back programs to help them integrate back into society and successfully complete their parole terms, resulting in a lower recidivism rate. Although the tradeoff may be difficult, achieving the desired benefits of using intermediate sanctions in lieu of returning eligible parole violators to prison requires a willingness to accept the additional risks associated with keeping individuals who are proven to be uncooperative in the community. The parole division minimized the risk to public safety by placing less-dangerous parole violators in the programs. However, depending on the program, this supervision or strict control occurred for between 30 days and an average of 45 days, which is significantly less than the average 153 days a parolee would have stayed in prison for parole violations.

Based on our data analysis, of the 2,567 parole violators placed in the SATCU program and 3,175 parole violators placed in the Halfway Back program by December 31, 2004, 128 (5 percent) and 114 (4 percent), respectively, were returned to prison for new convictions during the time they otherwise would have been in prison. Notwithstanding the significance of those crimes to their victims, the percentage of parolees participating in the two programs who were convicted of new crimes is small. An additional 1,732 parole violators placed in the Halfway Back and SATCU programs were returned to prison for committing parole violations during that time. However, the parole division had no benchmarks to determine whether these results were acceptable.

We recommend the parole division consider analyzing the effect programs have had on parolee behavior and use the knowledge it gains from the analyses to make future intermediate sanction programs more effective. The analysis should include the benefits of adding features to make these programs more effective.

Department's Action: Partial corrective action taken.

The parole division indicates that the department's office of research conducted a performance review of the seven parolee programs in October 2006. This review, which used data through June 2006, suggested adjustments to the outcome goals, which the parole division has accepted.

CALIFORNIA DEPARTMENT OF CORRECTIONS AND REHABILITATION

Investigations of Improper Activities by State Employees, January 2005 Through June 2005

INVESTIGATIONS I2004-0649; I2004-0681; I2004-0789 (REPORT I2005-2), SEPTEMBER 2005

California Department of Corrections and Rehabiliation's response as of September 2006

Investigative Highlight . . .

Department of Corrections and Rehabilitation failed to account for 10,980 hours of union leave time at a cost to the State of $395,256.

We investigated and substantiated allegations that the California Department of Corrections and Rehabilitation (Corrections) did not track the total number of hours available in a rank-and-file release time bank (time bank) composed of leave hours that union members donated.

Finding: Corrections failed to adequately account for time-bank hours.

Corrections lacked an adequate system of internal accounting and administrative controls over the number of hours in the time bank used by Peace Office Association members which allowed Peace Officer Association members to take release time without Corrections knowing whether the time-bank balance was sufficient to cover the anticipated leave.

We identified three employee representatives whom Corrections released for a combined total of 10,980 hours between May 2003 and April 2005, which cost the State $395,256, to perform duties for the Peace Officers Association and who were supposed to have this time charged against the time bank.

Corrections indicated that starting in the latter part of 2004, it began generating management reports that included information on time-bank use and donations and that it analyzes this information to better assess the overall impact of such union-leave activities. Although we acknowledge that Corrections has improved its monitoring of the time bank's activity, it still failed to account for a significant amount of time-bank hours used. Further, in the management reports that it used to assess current time-bank activity, Corrections did not accurately account for the hours that the three representatives used. Such errors

underscore the need for Corrections to improve its accounting to ensure that requests for time-bank use are charged against its balance and are sufficiently funded by employee leave donations.

Corrections' Action: Partial corrective action taken.

Corrections stated that it could not independently substantiate the 10,980 hours we reported as hours that Representatives A, B, and C did not charge to the union time bank between May 2003 and April 2005. Corrections believes that the State Controller's Office and Corrections' time accounting system cannot provide an accurate way to distinguish the type of union leave used. However, we substantiated the allegation when we reported the issue and Corrections has not requested to review our work papers. Further, it is not relevant to be able to distinguish the type of union leave used since our review of all available union leave categories at the State Controller's Office showed that none of the 10,980 hours were charged to any union leave categories.

Corrections reported that it has modified and implemented several changes to its tracking system that will allow it to track, report, and seek payment for union leave time. However, records from the State Controller's Office indicate that Corrections is still not charging the union time bank for the hours Representatives A and B are spending working on union activities. As a result, we have little confidence in Corrections' recent changes to its union leave tracking system. In addition to the 10,980 hours we previously reported, Corrections has failed to charge an additional 4,568 hours against the union time bank for hours Representatives A, B, and C spent working on union activities from May 2005 through June 2006. Overall, from May 2003 through June 2006, Corrections has failed to account for 15,548 hours of union leave at a cost to the State of $589,661.

CALIFORNIA DEPARTMENT OF CORRECTIONS

It Needs to Better Ensure Against Conflicts of Interest and to Improve Its Inmate Population Projections

REPORT NUMBER 2005-105, SEPTEMBER 2005

Audit Highlights . . .

Our review of the California Department of Corrections' (department) processing of two no-bid community correctional facility (CCF) contracts and its projections of inmate populations revealed the following:

- ☑ *Although one CCF contract was never executed, actions taken by two of the contractor's employees who formerly worked for the department may have violated conflict-of-interest laws.*
- ☑ *The department does not ensure that retired annuitants in designated positions file statements of economic interests.*
- ☑ *The department, the facility owner, and the potential contractor all incurred costs before the department received approval to proceed with a no-bid contract.*
- ☑ *Information the department relied upon to determine the need for the no-bid contracts appears accurate.*

continued on next page . . .

California Department of Corrections and Rehabilitation's response as of October 2006

The California Department of Corrections' (department) fiscal year 2003–04 budget did not include funds to continue the contracts for three private community correctional facilities (CCF). However, in 2004 the department experienced a large unexpected increase in inmate population because parole reform programs were not carried out and because new inmate admissions from counties increased. Since prior population projections had generally projected a stable population through 2009, the department did not expect this large increase. To respond to this situation, the department put thousands of added beds into use, some located in "overcrowding" areas—temporary beds placed in areas that are more difficult to secure, such as gymnasiums and dayrooms. In summer 2004, the Youth and Adult Correctional Agency and the department decided to reactivate two of the closed CCFs, McFarland and Mesa Verde, using one-year, no-bid contracts, while initiating a competitive bidding process for a longer-term solution.

The department's Population Projections Unit (projections unit) generates population projections for time frames that span six fiscal years, monitors and reports on the quality of the projections, and explains inconsistencies between actual and projected populations. The annual population projections correspond with the State's budget cycle and drive the department's annual budget request. The department prepares its budget request using the fall population projection and submits this request to the Department of Finance (Finance) for use in preparing the Governor's Budget. It revises its budget request based on the spring population projection and submits the revision to Finance for inclusion in the May revision of the Governor's Budget. The department also uses these projections to assess the ability of its facilities to house the inmate population over a six-year timeline.

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits evaluate the process the department used to negotiate and enter into two no-bid contracts for private prison facilities to determine whether its policies and procedures are

consistent with and adhere to current laws and regulations, particularly in relation to conflict-of-interest rules. In addition, the audit committee asked us to analyze information the department used in its decision to enter into the two no-bid contracts to determine whether such information was accurate and reliable, to analyze the reasonableness and consistency of its method of tracking and projecting inmate population, and to assess the validity of any cost savings it identified.

☑ *The department's inmate population projections are useful for budgeting, but have limited value for longer-range planning, such as determining when to build additional facilities.*

☑ *Because certain practices increase the subjectivity of the department's projections and no documentation of the projection process exists, our statistical expert could not establish the validity of the projection process.*

Finding #1: The department began incurring costs related to the Mesa Verde contract prior to receiving appropriate approval.

Before awarding a contract without competition, the department must obtain the approval of General Services. Also, as part of the contract award process, after General Services' approval of the request justifying an exemption from competitive bidding, the department operations manual requires contracts to be forwarded to the contractor for signature. This was the process the department used in executing the McFarland contract. However, it sent the Mesa Verde contract to the contractor for signature before obtaining General Services' approval of its justification for exemption. The department later rescinded its request for exemption because of a decline in inmate population and because of conflict-of-interest concerns. It did notify the contractor by letter that the contract was not fully approved or in effect until General Services gave its final approval. Nevertheless, the department, the facility owner, and the potential contractor all incurred costs before receiving approval from General Services.

We recommended that, to strengthen controls over its processing of no-bid contracts, the department wait until all proper authorities have approved the no-bid contract justification request before sending a contract to a contractor for signature or signing the contract itself.

Department's Action: None.

➲ The department states that its normal contract procedures comply with this recommendation. However, it further states that when timing is critical for procuring essential services, obtaining the contractor's signature in advance helps to expedite the process, but does not, in any way, execute the contract.

Finding #2: Although the department has controls in place to identify conflicts of interest, a conflict may have existed with the unexecuted Mesa Verde contract.

Despite conflict-of-interest disclosure requirements in the contract, Civigenics—the Mesa Verde contractor—did not disclose that two of its employees had worked for the department within the past year. As of July 2005, these same two Civigenics employees were also listed as current retired annuitants available to work at the department.

According to Civigenics officials, the company hired one former high-ranking department employee to develop a strategic plan and the other to help with the reactivation of Mesa Verde. The employment of the two individuals by both the department and Civigenics created potential conflicts of interest that, had the contract been fully executed, could have rendered it void. Moreover, certain contacts between these two individuals and the department during the contract formation process raise the possibility that conflict-of-interest laws were violated even though the contract was never fully executed.

We recommended that the department require key contractor staff to complete statements of economic interests (statements).

Department's Action: None.

➔ The department states it met with the Office of Legal Affairs (OLA) and it reviewed the department's contract requirements as they relate to conflict of interest and found that the department is in compliance with law and the directive given by the Office of the Attorney General in a memorandum on this issue. Nevertheless, while the OLA may have found the department to be in compliance with the law and a directive of the Attorney General's Office, its existing practice was not sufficient to warn it of potential conflicts of interest on the part of key contractor staff.

Finding #3: The department can improve its collection and review of required disclosure forms.

State law requires agencies to adopt a conflict-of-interest code that designates employees in decision-making positions and requires them to file periodic statements. Accordingly, the department has adopted regulations that list the designated positions and spell out the disclosure requirements. Although most of the employees who are assigned to designated positions with a role in developing the CCF contracts completed the required statements, some did not. All 20 department staff who had a role in developing the two facilities contracts we reviewed filed statements covering all or part of 2004, but two retired annuitants associated with one of these contracts did not. Also, the department does not ensure the completeness of the statements employees do file. Four of the 20 employees whose statements we reviewed filled out their statements incorrectly. Because the department does not review all the filed statements for accuracy or completeness, it cannot ensure that its employees in designated positions have met their respective disclosure requirements.

The department's practice of continuing former employees as active retired annuitants when they are not actually working could create confusion about whether its retired annuitants are subject to revolving-door prohibitions or the conflict-of-interest provisions that apply to current employees. According to the department, one of the primary reasons it hires staff who retire at the deputy director level and above as retired annuitants is to provide expert testimony in pending litigation. Typically, the department appoints retired annuitants to one-year terms and will reappoint them in the subsequent year if their services are still needed. However, because of the state hiring freeze in effect during 2001, the former department director issued a memo directing each institution and the department's headquarters personnel office to delete the expiration dates of all currently employed retired annuitants as of December 31, 2001, to eliminate the need to seek formal freeze exemptions approved by Finance each new calendar year. According to the chief of Personnel Services, although as of August 2005, the department is still abiding by its policy of not entering expiration dates on its appointments of retired

annuitants, it plans to ask each division to annually advise personnel services' staff which retired annuitants are no longer working. The department will then separate the identified retired annuitants from state service. However, until it implements this change, the department will continue to be at risk from potential conflicts of interest with its contractors and has no way of knowing if its retired annuitants are still needed.

We recommended that the department:

- Ensure that its retired annuitants in designated positions submit required statements.
- Ensure that statements submitted by staff are complete.
- When appointing retired annuitants, limit such appointments to a one-year period and require annual reappointment.
- Consider contracting with retired staff to provide expert testimony in litigation instead of its current practice of hiring them as retired annuitants.

Department's Action: Partial corrective action taken.

The department states that, as of May 2007 retired annuitants performing duties in designated positions will be required to annually file statements of economic interests. For other staff, the department states that it will perform a cursory review on the cover page of each statement of economic interests to ensure all items are complete. The department further states that it is posting expiration dates on all current retired annuitant appointments, and will enter a 12-month expiration date on all new appointments. Finally, the department is studying the feasibility of contracting with former employees to provide expert testimony in litigation rather than hiring them as retired annuitants.

However, as of October 2006 the department is still working with its technical support staff to develop a database for tracking positions required to file statements of economic interests and, therefore, is unable to conduct a reliable audit reconciling those staff required to file with those that did file.

Finding #4: The cost comparisons the department used to justify the no-bid contracts were incomplete.

Although the information on which the department based its decision to open two CCFs using no-bid contracts appears reasonable, its justification for these contracts included incomplete cost comparisons. The department stated in its justification that the two contracts represented a potential cost savings to the State because the per diem rates for the facilities are less than the daily jail rate of $59, the maximum the department can reimburse counties for detaining certain state parolees who have violated parole and therefore are being sent back to prison. However, the two costs are not comparable. Because the CCF contract amounts, unlike the daily jail rate, do not include all the costs of housing an inmate, the department's claim of cost savings is misleading. Compared to other CCF contracts in place in 2004, however, the average annual per-bed cost of the two no-bid contracts appears to be within a reasonable range.

We recommended that the department include all its costs when it decides to include cost comparisons in justification requests or state that the cost comparison is incomplete.

Department's Action: Corrective action taken.

The department states that future no-bid contract justifications containing cost comparisons or benchmarks used for housing inmates will be complete.

Finding #5: With high error rates, the department's longer-term projections do not accurately predict its need for inmate housing.

In developing its budgets, the department primarily relies on information from the first two years of a projection, which reflects the period for which the department is preparing a budget. The average error rate of the projection process in the first two years is less than 5 percent and therefore appears reasonable for this purpose. However, because of the time needed to build a new prison, the department also uses projections to assess the sufficiency of its facilities to house future inmate populations. For this assessment the department uses all six years of the projection period. The department's average error rate increases rapidly beginning in the third year, reaching almost 30 percent by the end of the sixth year. Therefore, the department's reliance on its projections in assessing the sufficiency of its facilities and planning future prison construction appears misplaced.

We recommended that, if the department intends to continue using the projections for long-term decision making, such as facility planning, it ensure that it employs statistically valid forecasting methods and consider seeking the advice of experts in selecting and establishing the forecasting methods that will suit its needs.

Department's Action: Pending.

The department states that, as of the end of October 2006, it is working with its contracts staff to establish a public entity agreement with Ohio State University. This is a departure from the department's six-month response, when it stated it was working with the Office of Research to establish an interagency agreement with statistical experts at either the CSU or UC systems to review the existing simulation model and projections process. Frankly, we do not understand why the department feels it necessary to contract with an out-of-state source when such expertise is located in Northern California, which would appear to be a more effective and efficient why to obtain the expert advise it needs.

Finding #6: The department does not properly update its projection data.

The department's projection model uses data from prior experiences to establish the likelihood of certain events occurring at steps along the projection process. For example, at a given point in the simulation model, an inmate hypothetically may have a 40 percent chance of being released on parole, a 50 percent chance of remaining in prison for at least another month, and a 10 percent chance of dying in prison. However, the department does not always properly update the frequencies—or relative percentages of the likelihood of different options occurring—using sufficient historical data. Rather than using a statistical process to develop the frequencies, the department takes the same frequencies used in its previous projection and then updates the

numbers based on analysts' experience and review of the actual data since the last projection. This method increases the possibility of bias entering into the projection. According to our statistical expert, the department cannot support its forecasts using its present methodology.

We recommended that, to increase the accuracy and reliability of its inmate projection, the department update its variable projections with actual information, whenever feasible to do so.

Department's Action: None.

The department states that it will develop a database that will store data and be used to update its variable projections in its simulation model. However, the department also stated that it has not yet started this effort and will not until it hires a retired annuitant in the spring of 2007 to begin work on this project.

Finding #7: Contrary to its policy, the projections unit used speculative estimates in its projections.

At the direction of the department and contrary to its own policy, the projections unit used estimates in its projections that are not based on past experience or that include information from programs whose effects could not be reasonably estimated in several instances. Specifically, in the 2004 spring and fall projections, the department's former chief deputy director of support services directed the projections unit to include the estimated effects of various parole reforms. According to the manager of the projections unit, these estimates were based on changing criteria, and the parole reforms in question had numerous issues that needed to be resolved before any reasonable expectation of population reductions could be estimated. From our review of department policy memos, we noted that criteria such as which inmates were eligible for these programs and the maximum amount of time inmates could be enrolled changed during the time period in which these projections were being made. Nonetheless, department management required the projections unit to include the estimates in its population projections, thus compromising the unit's independence. Without being able to function independently of internal or external pressure to use certain data or arrive at certain conclusions, the credibility of the projections unit's forecasts is diminished.

We recommended that the department disclose when a projection includes estimates for which inadequate historical trend data exists, such as the estimated effects of a new policy, and the specific effect such estimates have on the projection.

Department's Action: Corrective action taken.

The department states that, when a projection includes estimates for which inadequate historical trend data exists, it will publish two projections; one which will be based on historical trends and one which includes the estimates; it will show the impact that the estimates have on the trend projection. An example of this plan can be found in the department's Spring 2005 population projection.

Finding #8: The department failed to obtain information from counties that would have alerted it to rising admissions.

In addition to the unrealized effects of parole reforms, the spring 2004 population projection was also understated because of an unexpected rise in inmate admissions from counties. Because county superior courts sentence felons to state prison, changes in county policies on prosecuting criminals can affect inmate admissions at the state level. Los Angeles County was the primary source of the rising inmate admission rate during this period. According to the department's director, the new chief of police of the city of Los Angeles changed the city's approach to policing, increasing the number of people being sent to prison. However, until recently, the department did not have an effective process in place to communicate with local governments to identify such changes and their effect on the number of inmates being sentenced to prison. The department is developing ways to establish better communications with the counties.

We recommended that the department continue its recent efforts to enhance its communications with local government agencies to better identify changes that may materially affect prison populations.

Department's Action: Pending.

The department states that it is waiting for the California District Attorney's Association to take the next step in an effort to establish contacts with the district attorneys offices in major counties through the development and use of a shared database.

Finding #9: Lack of documentation casts doubt on the validity of the projection process.

To assess the statistical validity of its projection process, our statistical expert met with key department staff to review the documentation of the projection method. However, the department does not have documentation describing its complete projection model, so we were unable to assess its validity. According to our statistical expert, documenting a projection process, including the computer program used, is important so others can evaluate the process and understand its limitations and capabilities. She added that, for staff within the department, such documentation is very valuable for the continuity of the forecasting process when current staff retire or leave. She concluded that data analysis is a constantly evolving process and appropriate documentation is crucial in all stages to continuously improve the analysis as more and more data become available. According to the chief of the branch that includes the projections unit, it is currently revising the projection model and plans to produce documentation for the revised version.

We recommended that the department fully document its projection methodology and model.

Department's Action: Partial corrective action taken.

➲ The department states that it is in the process of writing documentation for its simulation model, and as of October 2006 is about 50 percent complete.

CALIFORNIA DEPARTMENT OF CORRECTIONS

Investigations of Improper Activities by State Employees, July 2004 Through December 2004

INVESTIGATION I2003-0834 (REPORT I2005-1), MARCH 2005

California Department of Corrections' response as of October 2006

Investigative Highlights . . .

The California Department of Corrections (Corrections) improperly granted registered nurses (nurses) an increase in pay associated with inmate supervision as follows:

- ☑ *Between July 1, 2001, and June 30, 2003, Corrections paid 25 nurses $238,184 more than they were entitled to receive.*
- ☑ *Corrections failed to maintain sufficient documentation for 17 of the 25 nurses and although Corrections provided records for the remaining eight nurses, we found that most of these nurses failed to incur the required number of supervisory hours to merit the pay increase.*

We investigated and substantiated an allegation that the California Department of Corrections (Corrections)[1] improperly granted registered nurses (nurses) an increase in pay associated with inmate supervision that they were not entitled to receive.

Finding: Corrections improperly granted nurses premium pay associated with inmate supervision.

We found that 25 nurses at four institutions received increased pay associated with inmate supervision even though they either did not supervise inmates for the minimum number of hours required or they lacked sufficient documentation to support their eligibility to receive the increased pay. Between July 1, 2001, and June 30, 2003, Corrections paid these nurses $238,184 more than they were entitled to receive.

Corrections reported that it could not provide documentation to support the pay increase it authorized for 17 of the 25 nurses because the institutions that employed these nurses either had no inmate supervisory hours to report, did not require nurses to track these hours, lacked sufficient documentation to support the hours claimed, or had destroyed all timekeeping records relating to inmate supervision. Although Corrections provided figures showing that the remaining eight nurses did supervise inmates, we found that in most instances these nurses failed to incur the required number of supervisory hours to merit the pay increase. For example, one nurse received a pay increase of approximately $7,983 over a 16-month period. However, the nurse met the inmate supervisory threshold of 173 hours per month on only two occasions, resulting in an overpayment of $7,030. Of the 25 nurses we reviewed that received this premium pay, we found that $238,184 of the $255,509 in inmate supervisory pay received was not justified.

[1] As of July 1, 2005, the California Department of Corrections has been renamed the Department of Corrections and Rehabilitation.

Corrections' Action: Partial corrective action taken.

Corrections reported that it has completed its analysis and determined that 14 of the 25 nurses identified in our report were not entitled to the pay increase and has collected or initiated collection for overpayments from these nurses. Corrections also reported that 11 of the nurses we identified were entitled to receive the pay increase. However, it was unable to provide documentation to support the premium pay for 10 of these nurses, stating that the institution only required the nurses to maintain copies of inmate supervision records for one year. Finally, Corrections reported that none of the nurses identified in our report are currently receiving the pay increase.

EMERGENCY PREPAREDNESS

More Needs to Be Done to Improve California's Preparedness for Responding to Infectious Disease Emergencies

REPORT NUMBER 2004-133, AUGUST 2005

Audit Highlights . . .

Our review of California's preparedness for responding to an infectious disease emergency revealed the following:

- ☑ *The Emergency Medical Services Authority has not updated two critical plans: the Disaster Medical Response Plan, last issued in 1992, and the Medical Mutual Aid Plan, last issued in 1974.*
- ☑ *The Department of Health Services (Health Services) does not have a tracking process for following up on recommendations identified in postexercise evaluations, known as after-action reports.*
- ☑ *Although Health Services has completed 12 of 14 critical benchmarks it was required to complete by June 2004 for one cooperative agreement, we cannot conclude it completed the other two. In addition, Health Services has been slow in spending the funds for another cooperative agreement.*

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Department of Health Services, Emergency Medical Services Authority, and five local public health department's responses as of October 2006[1]

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the State's preparedness to respond to an infectious disease emergency requiring a coordinated response between federal agencies, the Department of Health Services (Health Services), local health agencies, and local infectious disease laboratories. Specifically, the audit committee requested that we (1) evaluate whether Health Services' policies and procedures include clear lines of authority, responsibility, and communication between levels of government for activities such as testing, authorizing vaccinations, and quarantine measures; (2) determine whether Health Services has developed an emergency plan; (3) determine whether California's infectious disease laboratories are integrated appropriately into statewide preparedness planning for infectious disease emergencies; (4) determine if the management practices and resources, including equipment and personnel, at the state health laboratories are sufficient to respond to a public health emergency; and (5) review Health Services' standards for providing oversight to local infectious disease laboratories, and determine whether its oversight practices achieved their intended results.

The audit committee further requested that we evaluate whether a sample of local infectious disease laboratories are operated and managed effectively and efficiently and have the necessary resources to respond to an emergency, including sufficient equipment and personnel with the appropriate level of experience and training. We also were asked to review the local laboratories' testing procedures for infectious diseases and determine if they meet applicable standards.

[1] The five local public health departments are: County of Los Angeles, Department of Health Services (Los Angeles); Sacramento County Department of Health and Human Services, Division of Public Health (Sacramento); County of San Bernardino, Department of Public Health (San Bernardino); Santa Clara County, Public Health Department (Santa Clara); Sutter County, Human Services Department (Sutter).

☑ *None of the five local public health departments we visited have written procedures for following up on recommendations identified in after-action reports.*

☑ *None of the five local public health departments we visited had fully completed the critical benchmarks for a cooperative agreement by the June 2004 deadline.*

Finding #1: The Emergency Medical Services Authority needs to update two critical plans.

The Emergency Medical Services Authority (Medical Services) has not updated two emergency plans: the *Disaster Medical Response Plan* and the *Medical Mutual Aid Plan*, the latest versions of which are dated 1992 and 1974, respectively. The state emergency plan, issued in 1998, mentions both plans and describes them as "under development." The state emergency plan indicates that state entities would use the two plans to help respond to emergencies caused by factors that include epidemics, infestation, disease, and terrorist acts, therefore, we believe the two plans are critical for California's successful response to infectious disease emergencies. Medical Services agrees that the plans must be updated to ensure that they reflect the State's current policies and account for any changes in roles or responsibilities since they originally were issued. According to the chief of the Medical Services' Disaster Medical Services Division, these plans have not been updated because Medical Services lacks resources and has competing priorities.

We recommended that Medical Services update the *Disaster Medical Response Plan* and the *Medical Mutual Aid Plan* as soon as resources and priorities allow.

Medical Services' Action: Pending.

Medical Services stated that it has completed initial drafts of a State Disaster Medical Plan and a Medical Mutual Aid component. As of December 2006, Medical Services was circulating the drafts for review and comment. Medical Services stated that revised drafts will be completed by December 31, 2006, and then forwarded to the Governor's Office of Emergency Services for its formal review.

Finding #2: Health Services does not have a tracking method to ensure that it benefits from the lessons it learned.

Health Services could improve its ability to learn from its experiences by developing and implementing a tracking process for following up on the recommendations made in its postexercise evaluations, known as after-action reports. According to guidelines developed by the U.S. Department of Homeland Security's Office for Domestic Preparedness, after-action reports are tools for providing feedback, and entities should establish a tracking process to ensure that improvements recommended in after-action reports are made. Similarly, the National Fire Protection Association also suggests in its Standard on Disaster/Emergency Management and Business Continuity Programs (2004 edition) that exercise participants establish procedures to ensure that they take corrective action on any deficiency identified in the evaluation process, such as revisions to relevant program plans. An exercise allows the participating entities to become familiar, in a nonemergency setting, with the procedures, facilities, and systems they

have for an actual emergency. The resulting after-action reports give these entities an opportunity to identify problems and successes that occurred during the exercise, to take corrective actions, such as revising emergency plans and procedures, and thus benefit from lessons learned from the exercise. Therefore, we believe that tracking the implementation status is a sound practice to ensure that state entities address all relevant recommendations in after-action reports, which can then serve as important tools for increasing overall preparedness levels.

In response to our concerns that Health Services lacked a written policy and procedures for following up on recommendations identified in after-action reports for exercises, the deputy director for public health emergency preparedness provided us on July 14, 2005, with the recently developed policy and procedures. However, our review of the policy found that it does not include a standard format for tracking the implementation of recommendations, such as assigning an individual the responsibility for taking action, the current status of recommendations, and the expected date of completion. Therefore, Health Services still needs to refine its policy further by developing and implementing written tracking procedures to ensure it addresses all relevant recommendations that it identifies in after-action reports. Without a tracking method, Health Services cannot be certain that it takes appropriate and consistent corrective action, such as revising emergency plans, and thus reduces its potential effectiveness to respond to infectious disease emergencies.

We recommended that Health Services develop and implement a tracking method for following up on recommendations identified in after-action reports.

Health Services' Action: Corrective action taken.

Health Services developed and implemented a policy on after-action reporting in response to our draft report on July 25, 2005. This policy and the associated procedures provide a specific tool for tracking recommendations identified in after-action reports.

Finding #3: We cannot conclude that Health Services completed a critical benchmark requiring it to assess its preparedness to respond to infectious disease emergencies.

In the aftermath of the terrorist attacks in September 2001, and the anthrax attacks later that year, two federal agencies—the Centers for Disease Control and Prevention (CDC) and the Health Resources and Services Administration (HRSA)—offered cooperative agreements to states, local jurisdictions, and hospitals and other health care entities. The cooperative agreements are intended to provide increased funding to improve the nation's preparedness for bioterrorist attacks and other types of emergencies, including those caused by infectious diseases. However, despite making progress toward completing many of the critical benchmarks established in the CDC cooperative agreement with a June 2004 deadline, we cannot conclude as of our review that Health Services completed critical benchmark number 3, which requires the State to assess its emergency preparedness and response capabilities related to bioterrorism, other infectious disease outbreaks, and other public health threats and emergencies with a view to facilitating planning and setting implementation priorities. Therefore, California may not be as prepared as it could be to respond to infectious disease emergencies.

According to its deputy director for public health emergency preparedness (Health Services' deputy director), Health Services prepared an assessment as did all local health departments. She also stated that some staff documented parts of their assessment and that Health Services' application

for CDC funding in 2004 included references to the assessments. However, she also acknowledged that Health Services did not prepare a single written summary of the assessment it prepared and the assessments prepared by local health departments. Without such a summary and without complete documentation of the assessments, Health Services has not demonstrated to our satisfaction that it has fully completed critical benchmark number 3. Health Services' deputy director also told us that to obtain a more current assessment, Health Services has entered into a contract with the Health Officers' Association of California (HOAC) to be conducted from mid-2005 through December 2006.

We recommended that Health Services should ensure that the contractor performing the current capacity assessment provides a written report that summarizes the results of its data gathering and analyses and contains applicable findings and recommendations.

Health Services' Action: Pending.

Health Services stated that it has contracted with HOAC for an assessment of public health emergency preparedness in 61 local health departments. Health Services indicated that 39 local assessments have been completed as of July 2006 and all assessments are to be completed by the end of December 2006. Further, it is requiring HOAC to provide written reports that summarize the results of the analyses and contain applicable findings and recommendations for improvements.

Finding #4: Local public health departments could do more to address after-action reports.

Local emergency plans, such as the counties' overall emergency operation plans and local public health departments' (local health department) emergency operations and response plans, generally included sufficient guidance for emergency preparedness; however, the plans did not include specific procedures for following up on recommendations identified in after-action reports. When we asked officials of the local health departments, they agreed with our assessment and confirmed that they did not have written procedures for following up on recommendations in after-action reports although Los Angeles County has developed a draft policy.

Moreover, the California Code of Regulations requires state entities to complete after-action reports for declared emergencies within 90 days of the close of the incident. There is no requirement for preparing after-action reports for an exercise or drill as there is for a declared emergency, but we believe that promptly writing after-action reports for exercises is prudent and equally relevant. Waiting longer than 90 days to complete the reports might make it more difficult for the individuals involved in the exercise to recall specific details accurately. Therefore, we expected all participants in the November 2004 exercise hosted by Medical Services to have prepared after-action reports within 90 days to identify any weaknesses in plans and procedures and to take appropriate corrective actions. However, as of July 2005, the after-action report from Los Angeles County's health department was still in draft stage, which is approximately seven months after the exercise. According to the executive director of the county's Bioterrorism Preparedness Program (executive director), the Los Angeles County health department had not yet implemented all the recommendations identified. The executive director stated that it experienced delays in drafting its after-action report because the individuals who participated in the exercise were inexperienced with the formalized after-action report process and completing the surveys and observations needed. She further stated that several drafts were reviewed and resubmitted by its management. However,

because the Los Angeles County health department did not complete its after-action report promptly, it did not address all the recommendations as quickly as it could have. Consequently, it is not as prepared as it could be to respond to infectious disease emergencies.

We recommended that local health departments establish written procedures for following up on recommendations identified in after-action reports and that they prepare after-action reports within 90 days of an exercise.

Local Public Health Departments' Actions: Partial corrective action taken.

The five local health departments we visited generally indicated that they have developed written procedures for following up on recommendations identified in after-action reports. Also, four of the five local health departments indicated they prepared after-action reports within 90 days. The fifth local health department, Sutter County, did not address this part of the recommendation.

Finding #5: Not all local public health departments have met the deadline to implement several federal benchmarks.

None of the local health departments we visited had met all 14 of the CDC 2002 critical benchmarks by the required deadline of June 2004. Specifically, Los Angeles and Sacramento counties health departments did not meet the June 2004 deadline, but they report that they have since completed the benchmarks. Further, Sutter and Santa Clara counties did not meet one of the 14 2002 critical benchmarks as of June 2005, and San Bernardino County did not meet three. The purpose of the CDC cooperative agreement is, in part, to upgrade local health departments' preparedness for and response to bioterrorism, outbreaks of infectious disease, and other public health threats and emergencies. Therefore, by not meeting the critical benchmarks, these jurisdictions may not be as prepared as possible to respond to an infectious disease emergency.

We recommended that local health departments complete the critical benchmarks set by the CDC cooperative agreement as soon as possible.

Local Public Health Departments' Actions: Partial corrective action taken.

Los Angeles and Sacramento counties' health departments reported that they had completed the critical benchmarks. Additionally, Santa Clara now reports that it has completed its last benchmark while San Bernardino reports completing two of three outstanding benchmarks. Finally, Sutter County indicated that it is still working to complete critical benchmarks.

BOARD OF EQUALIZATION

Its Implementation of the Cigarette and Tobacco Products Licensing Act of 2003 Has Helped Stem the Decline in Cigarette Tax Revenues, but It Should Update Its Estimate of Cigarette Tax Evasion

REPORT NUMBER 2005-034, JUNE 2006

Board of Equalization's response as of December 2006

Audit Highlights . . .

Our review of the Board of Equalization's (Equalization) implementation of the Cigarette and Tobacco Products Licensing Act of 2003 (act) revealed the following:

- ☑ *Based on its analysis of cigarette tax stamps sold, Equalization estimates it received $75 million in additional cigarette tax revenues between January 2004 and March 2006 because of the act and the new tax stamp.*
- ☑ *Equalization's estimate of $292 million in annual cigarette tax evasion is based on an unrepresentative sample and an overstated number of retailers of cigarettes and tobacco products.*
- ☑ *Although the act and new tax stamp have caused a stabilization of the historical decline in cigarette tax revenues, these revenues will continue to decline as long as more Californians stop smoking.*

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Section 22971.1 of the Business and Professions Code (code) requires the Bureau of State Audits to conduct a performance audit of the licensing and enforcement provisions of the Cigarette and Tobacco Products Licensing Act of 2003 (act) and report its findings by July 1, 2006. The code section requires the report to include the following information: (1) the actual costs of the program, (2) the level of additional revenues generated by the program compared with the period before its implementation, (3) tax compliance rates, (4) the costs of enforcement at the various levels, (5) the appropriateness of penalties assessed, and (6) the overall effectiveness of enforcement programs. We found that:

Finding #1: The Board of Equalization uses its analysis of taxes paid to support its position that cigarette tax compliance has improved.

At the request of Board of Equalization (Equalization) management, Equalization's chief economist performed an analysis and estimated that the act generated $75 million in additional revenues from cigarette sales between January 2004 and March 2006. This estimate is based on Equalization's calculation of an average annual decline in cigarette sales (and by extension, cigarette consumption) of 3 percent over the past 22 years as measured by the number of tax stamps sold, which Equalization calls the tax paid distribution.[1] The 3 percent decline reflects several factors, including fewer people smoking and tax evasion. Equalization's 3 percent decline is consistent with the 2.3 percent average annual decline in smoking prevalence among California adults between 1997 and 2004, based on information published by the Tobacco Control Section of the Department of Health Services.

[1] Equalization's calculation actually showed that the tax paid distribution had decreased by an average of 3.8 percent annually, but for the purposes of its analysis of the effects of the act, it reduced the estimate to the more conservative 3 percent.

- ☑ ***In fiscal years 2003–04 and 2004–05, Equalization spent $9.2 million to implement the provisions of the act, with most of that amount paid toward staff salaries and benefits for licensing and enforcement activities.***
- ☑ ***Equalization imposes penalties in accordance with the provisions of the act.***

Equalization assumes that if all factors are equal and the market does not experience major changes, any variations in tax paid distributions are the result of Equalization's implementing the provisions of the act and, after January 2005, its new tax stamp. When Equalization compared its estimate of an annual average decline in cigarette consumption of 3 percent to the change in the rate of sales of cigarette tax stamps since the act went into effect, it found that sales of cigarette tax stamps were greater than it expected based on the historical data. By multiplying the difference in expected sales of cigarette tax stamps and actual stamps sold by the 87 cents cigarette tax rate per pack, Equalization calculated that cigarette tax revenues increased by $75 million between January 2004 and March 2006. Equalization attributes this to its additional enforcement authorized by the act, although Equalization concurs that the replacement, starting in January 2005, of its old cigarette tax stamp with a new stamp encrypted with a unique digital signature may also play a part.

Rather than relying on cigarette tax stamps sold, we prepared an estimate of the effect of the act using actual revenues collected, and our results were similar to those of Equalization. To determine how the act affected actual collections of cigarette tax revenues, we used Equalization's methodology but replaced the tax paid distributions with the actual cigarette tax revenues that Equalization collected. Our analysis indicates that actual revenues were about $49 million higher in calendar year 2004 and nearly $79 million higher in calendar year 2005 compared with the revenues expected for the same years, assuming a 3 percent average annual decline in consumption. The higher collection of cigarette tax revenues in calendar years 2004 and 2005 compared with the expected revenues shows that certain factors were causing the reversal of the historical decline in cigarette tax stamps sold. The smoking prevalence rates among California adults as determined by the Tobacco Control Section of the Department of Health Services for calendar years 2003 and 2004 show declines of 2.4 percent and 4.9 percent, respectively. Therefore, we assume that the increased collections of cigarette tax revenues are the result of increased compliance with cigarette taxes. However, neither Equalization nor we can isolate how much of the increased revenue in calendar year 2005 was the result of the act and how much was the result of the new tax stamp.

Finding #2: Equalization based its $292 million estimate of cigarette tax evasion on an unrepresentative sample.

In 2003, Equalization estimated that cigarette tax evasion—lost taxes to the State because of illegal sales of counterfeit cigarettes—amounted to $292 million for fiscal year 2001–02.[2] However, we believe Equalization's estimate is inflated because it reviewed a sample of retailers that is not

[2] The term *counterfeit cigarettes* refers to cigarette packs that bear counterfeit tax stamps as well as truly counterfeit products—cigarettes manufactured overseas and patterned after major brands.

representative of all retailers in the State and the number of retailers it used in its calculation of the estimate is overstated. Moreover, Equalization has not updated its tax evasion estimate since 2003 but continues to use that amount as the amount that the State loses each year from cigarette tax evasion.

Equalization attempted to determine the extent of California's counterfeit cigarette problem by having its Investigations Division (Investigations) review roughly 1,300 retailer inspections conducted throughout California between July 2001 and September 2002. Based on the results of the inspections, 25 percent of the State's retailers were selling counterfeit cigarettes, resulting in Equalization's estimate of $238 million in cigarette tax evasion by retailers that purchase and distribute untaxed cigarettes to consumers. In addition, Equalization estimated that individual consumers evade cigarette taxes totaling about $54 million each year by purchasing cigarettes over the Internet or by purchasing cigarettes in other states that have lower cigarette taxes. Thus, Equalization estimated that annual cigarette tax evasion totaled $292 million for fiscal year 2001–02.

Because Equalization's inspectors typically visit stores and areas more likely to exhibit noncompliance—a reasonable approach given its workload and staff—Equalization likely overestimated retailer tax evasion for the entire State. Investigations did not visit major grocery and discount chains, which Equalization pointed out have not historically posed problems with cigarette tax compliance. Additionally, because of limited resources, Equalization focused its inspections on major metropolitan areas. Consequently, the actual percentage of retailers in California that carry counterfeit or untaxed cigarettes is likely less than the 25 percent identified by the inspections, and the amount of cigarette tax evasion Equalization estimated may be overstated.

In addition, the number of retailers Equalization used to estimate cigarette tax evasion appears to be overstated, which also results in an overestimation of the $238 million in cigarette tax evasion by businesses. Assuming that retail locations that sell alcohol also sell cigarettes, Investigations originally estimated that about 85,000 retail locations in California sold cigarettes, because this was the number of retail locations licensed by the California Department of Alcoholic Beverage Control. However, after passage of the act, only about 40,000 retailers registered as selling cigarettes. Thus, Equalization's original estimate of 85,000 retailers was overstated, although the number of small businesses that stopped selling cigarettes because of the act's licensing requirements may have accounted for a portion of the difference. Using 40,000 as the number of retailers in Equalization's formula results in an estimated amount of cigarette tax evasion by retailers of $112 million, which is $126 million less than Equalization's estimate. Since the act was implemented, Equalization has not updated its cigarette tax evasion estimate, even though many of the factors have changed since it prepared its original estimate.

To provide a more accurate estimate of the extent of cigarette tax evasion, we recommended that Equalization update its calculation of cigarette tax evasion using data gathered after implementation of the act.

Equalization's Action: Partial corrective action taken.

Equalization reported that it is developing an updated econometric modeling approach to create an independent estimate of cigarette tax evasion. With its response, Equalization submitted a revised work plan that shows a completion date of May 2007 for this project. Equalization states that the revision will allow it to use the most recent information available from its work related to out-of-state sellers of cigarettes and tobacco products.

Finding #3: The act has had a positive effect on tax revenues from cigarettes and tobacco products.

Collections of cigarette tax revenues fell between fiscal years 2001–02 and 2004–05, although they stabilized at about $1.025 billion in fiscal years 2003–04 and 2004–05. As we noted previously, the stabilization and reversal of the historical decline in cigarette tax revenue is to some degree the result of the implementation of the act, in addition to the effects of the new cigarette tax stamp. However, collections of cigarette tax revenues will continue to decline as long as more Californians quit smoking.

Collections of the tobacco products surtax have varied from year to year and are not demonstrating a consistent trend. According to Equalization, the tobacco products category comprises several different products, including cigars, snuff, and chewing tobacco, and the market for each product relies on unique demographic and income characteristics. Without the act, Equalization believes that wholesale sales of tobacco products would not have changed from calendar years 2003 to 2004. However, wholesale sales for tobacco products jumped 38.9 percent in calendar year 2004, leading to an estimated $14 million increase in tax revenue from tobacco products. Because national data do not show an increase in tobacco product sales during that period and Equalization is unaware of any anecdotal evidence demonstrating why the rise occurred, it appears that the most likely reason for the increase is the set of regulatory changes brought about by the act.

Actual revenues for the administrative and license fees that the act instituted were greatest in fiscal year 2003–04, with some collections occurring in fiscal year 2004–05. The administrative fee is a one-time fee that will continue to generate some revenue as new manufacturers and importers qualify to do business in California. In addition, a modest amount of revenue will continue to be realized from distributors and wholesalers paying the $1,000 annual renewal fee. Also, a retailer that changes ownership or opens a new sales location must obtain a license and pay the license fee. Collections of fines assessed on civil citations do not currently play a large role in total revenues, but may increase over time.

Finding #4: Costs of carrying out the provisions of the act largely comprise staff salaries and benefits.

In fiscal years 2003–04 and 2004–05, Equalization spent $9.2 million to implement the provisions of the act, with most of that amount paid toward staff salaries and benefits. A large portion of the costs in the first two years were for enforcing the provisions of the act, although licensing activities and overhead costs to make programming changes to Equalization's information systems were a large proportion of costs that Equalization incurred in fiscal year 2003–04.

Finding #5: In addition to having a reasonable investigative process, Equalization imposes penalties in accordance with the act.

Investigations has a clearly defined and reasonable process for conducting inspections and investigations relating to cigarettes and tobacco products. Furthermore, the Excise Taxes and Fees Division (Excise Taxes) has documented and Equalization's five-member board (board) has approved procedures to assess penalties in accordance with the provisions of the act. Based on our testing of felony investigations and inspection citations, we determined that Investigations and Excise Taxes follow the procedures for conducting inspections and investigations, issuing citations, and assessing penalties for civil citations. By following board-approved procedures, Equalization can maintain case-to-case consistency and ensure that it is enforcing the provisions of the act.

DEPARTMENT OF FINANCE

Investigations of Improper Activities by State Employees, July 2004 Through December 2004

INVESTIGATION I2004-1104 (REPORT I2005-1), MARCH 2005

Department of Finance's response as of March 2006

Investigative Highlight . . .

The Department of Finance improperly divulged confidential information.

We investigated and substantiated an allegation that the Department of Finance (Finance) improperly disclosed confidential information.

Finding: Finance improperly disclosed confidential information.

In violation of privacy rights, Finance published the name and Social Security number of a former state employee in a publication that is distributed throughout the State and is available on the World Wide Web. In addition, Finance identified two other state employees and a state vendor whose names and Social Security numbers had also been improperly disclosed.

Finance's Action: Corrective action taken.

Finance removed the confidential information from its Web site and from any Web search engines that may have archived information from its Web site prior to being updated. In addition, Finance provided hard copy updates, without the confidential information, to users of the publication and revised its procedures to prevent violations of this nature in the future. Finally, Finance took steps to notify those individuals of the improper disclosure.

DEPARTMENT OF GENERAL SERVICES

Opportunities Exist Within the Office of Fleet Administration to Reduce Costs

REPORT NUMBER 2004-113, JULY 2005

Audit Highlights . . .

Our review of the Office of Fleet Administration (Fleet) within the Department of General Services found that:

- ☑ *Fleet's analyses, indicating that its vehicle rental rates are competitive with those of commercial rental companies, do not fully demonstrate its cost-effectiveness because Fleet lacks assurance that the commercial rates it used are similar to what state agencies typically pay.*
- ☑ *The terms of the current contracts that Fleet has with commercial rental companies and the noncompetitive method it uses to select companies may not be in the State's best interest.*
- ☑ *Fleet currently lacks a minimum-use requirement for vehicles that state agencies rent on a long-term basis as well as standards related to the idleness of its short-term rental vehicles, both of which could identify opportunities to reduce the number of vehicles in its motor pool.*

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Department of General Services' response as of July 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) conduct an audit of state-owned vehicles with a focus on the cost-effectiveness of the garages that the Office of Fleet Administration (Fleet) within the Department of General Services (General Services) operates. Specifically, the audit committee asked the bureau to determine whether General Services has a process in place to measure the cost-effectiveness of its garages and fleet of rental vehicles and, to the extent possible, determine whether it is cost-effective for the State to own, maintain, and rent its vehicles and own and operate its garages. Additionally, the audit committee asked the bureau to evaluate the potential for cost savings resulting from no longer having Fleet own and maintain vehicles and the potential savings from the consolidation and/or disposition of state-operated garages. Finally, the audit committee asked the bureau to review and evaluate General Services' policies and procedures for ensuring the accountability of state vehicle purchases, including the controls in place to monitor vehicle purchases and determine whether other state agencies purchase motor vehicles in accordance with applicable requirements and in the best interest of the State. We found the following:

Finding #1: Fleet's analyses of its cost-effectiveness indicate that it is competitive, but its analyses are limited.

To measure its cost-effectiveness, Fleet periodically compares its rates to those of commercial rental companies. The commercial rental rates used in the analyses were generally either rates, obtained through the Internet or by telephone or e-mail, that the companies offered to the general public at individual locations in the State or the maximum rates that the companies have agreed to in their contracts with Fleet. When Fleet compared the two amounts for each vehicle type, the comparisons indicated that its rates are competitive with those that commercial rental companies offer and that state agencies save money by using Fleet's services when they are available.

- ☑ *Fleet is responsible for overseeing the vehicle purchases made by state agencies, but its policy defining minimum usage, which Fleet is supposed to consider when assessing a state agency's need to purchase vehicles, may be set too low.*
- ☑ *Fleet's actions contributed to a $1.4 million deficit at June 30, 2004, in the fund that Fleet uses to operate and maintain parking lots for state employees.*

However, Fleet lacks assurance that the rates state agencies typically pay are similar to the companies' public rates because state agencies are generally required to rent vehicles using the contracts that Fleet has with commercial rental companies; therefore, state agencies would pay the rates offered under the terms of Fleet's contracts. Further, the maximum contract rates used in earlier analyses do not provide for a meaningful comparison because, as Fleet acknowledges, commercial rental companies do not typically charge such high rates.

A more comprehensive way to measure Fleet's cost-effectiveness would be to compare Fleet's costs to operate the motor pool to how much the State would spend using commercial rental companies, considering the rates that the companies typically charge the State. Fleet's contracts with commercial rental companies require them to submit quarterly data to Fleet that could help it determine how much the companies charge state agencies for their services. However, the reports that Fleet receives do not currently identify the average monthly, weekly, or daily rental rates the companies charge by vehicle type. If Fleet required its contractors to report information that would help it determine how much state agencies typically pay, those amounts would be a better basis of comparison.

We recommended that in addition to rate comparisons, Fleet should compare the actual cost of operating its motor pool to the amount that the State would pay commercial rental companies. In doing so, Fleet should use the actual motor pool rental activity, such as the number of days or months that it rents vehicles by each vehicle type, and apply it to rates that commercial rental companies actually charge state agencies. To understand how much state agencies typically pay when using the services of contracted commercial rental companies, Fleet should require, through its contracts, that the companies report information on vehicle rentals that would enable Fleet to determine the average daily or monthly rate actually charged for each vehicle type.

General Services' Action: Partial corrective action taken.

General Services reports that it has worked to obtain additional management information from its automated fleet management information system. Thus, Fleet is now able to more accurately compare the actual cost of operating its motor pool to the amounts that commercial rental companies charge state agencies. Additionally, according to General Services, it entered into new commercial car rental contracts that began on January 1, 2006, which include provisions for the receipt of information on actual charges incurred for the daily and weekly leasing of vehicles. General Services states that it will use this information in future cost-effectiveness studies.

Finding #2: Existing contracts raise questions as to whether they are in the best interest of the State.

We question whether the contract terms and the noncompetitive method that Fleet uses to select commercial rental companies result in contract rates that are as beneficial to the State as they could be. According to Fleet's chief, the intent of the contracts is to ensure that state employees renting vehicles from commercial rental companies are protected against companies charging them whatever they want. However, the amounts that commercial rental companies actually charge can be significantly lower than the maximum rates specified in the contracts.

An individual representing two of the seven companies with which Fleet contracts stated that Fleet requires the maximum rates in the contracts to encompass all fees such as airport or county fees and that this must be carefully considered as these fees are out of his companies' control. Further, he said that the contract rates have a large cushion built in to protect against vehicle price increases that could occur over the potentially long contract term. Although its contracts are for one year, Fleet can twice exercise the option to extend a contract for one year.

Fleet also requires commercial rental companies to insure the vehicles while state employees drive them, which raises rates. Fleet does not know if this requirement is in the State's best interest because it has not conducted an analysis and could not tell us the cost that insurance adds to commercial rental rates in Fleet's contracts. For example, it has not compared the cost of insuring cars through the commercial rental companies to the costs of other methods, such as self-insuring. If the State is able to self-insure commercially rented vehicles or purchase insurance for less than what it pays through its existing contracts, the rates that commercial rental companies offer the State could decrease significantly.

While still renting under Fleet's contract with one rental company, at least one state agency has an agreement with the company to guarantee lower rates than those specified under the company's contract with Fleet. Such agreements indicate that a more competitive process of selecting contractors may result in lower rates to the State. Because Fleet does not offer the State's business exclusively to one or two companies, contractors may not have an incentive to offer a lower rate during the contract proposal process.

Fleet acknowledges that a more competitive method of selection that would not limit availability of services could result in lower rates. In May 2005, the chief told us that Fleet was exploring a new option for state travelers that would employ competitively bid rental contracts with awards made to a primary and secondary commercial rental company. She also said that Fleet planned to contract for the base cost of vehicles (the cost before additional fees such as airport fees) to recognize the fees that vary by location.

We recommended that before seeking additional commercial rental contracts, Fleet should do the following:

- Determine if it can obtain lower guaranteed contract rates for the State by evaluating the extent to which using contracts that contain extension options contributes to maximum contract rates that are significantly higher than rates that the commercial rental companies could charge.

- Determine if paying for insurance when renting vehicles from commercial rental companies rather than other methods, such as self-insurance, is in the best interest of the State.

- Continue its efforts to obtain lower rates from commercial rental companies by pursuing options for a more competitive contracting process.

General Services' Action: Partial corrective action taken.

According to General Services, Fleet pursued a competitively bid process that allowed for awards to be made to one primary and one secondary car rental company instead of the previous system whereby seven different companies provided services to the State's employees. General Services states that the contracts it awarded, which are for January 2006 through December 2008, should save the State about $3 million in each of the three years. Additionally, according to General Services, unlike the contracts in place during the audit, the new commercial car rental contracts do not allow the contracted rental car company to charge customers any amount up to a maximum rate identified in their contracts. Instead, the awarded contracts require rental charges to be based on guaranteed set rates. Moreover, General Services told us that the Office of Risk and Insurance Management helped Fleet determine the bidder proposal that represented the best value to the State.

Finding #3: Fleet has not established certain requirements and standards related to vehicle use.

Although Fleet has established a minimum-use policy to ensure that state agencies efficiently operate the vehicles they own, it has no such requirement for vehicles that state agencies rent from the motor pool on a long-term basis. Without such a utilization policy, Fleet cannot ensure that its motor pool is used optimally.

By not requiring state agencies to meet a minimum-use requirement for long-term rentals, Fleet may in effect be allowing state agencies that cannot justify vehicle purchases based on usage to obtain vehicles by renting them from Fleet on a long-term basis. Since the function of a minimum-use requirement is to minimize costs, the absence of such a policy can result in higher costs to the State.

In addition to not establishing a minimum-use requirement for its long-term rentals, Fleet has not developed performance measures to determine if the vehicles that it rents on a short-term basis are idle an excessive number of days. Best practices indicate that fleet managers should set policies and develop performance measures to ensure that their fleets consist of the appropriate number of vehicles in the appropriate composition.

In May 2005, Fleet's chief told us that Fleet is putting in place a method for collecting and analyzing data for a minimum-use requirement that will be identical to the requirement for agency-owned vehicles. Fleet expected to make its policy effective in July 2005. The chief also told us that it was developing performance standards to better assess utilization and idle time. Once Fleet establishes these standards, it can monitor its performance and identify opportunities to reduce the number of vehicles it owns.

To ensure that the vehicles in Fleet's motor pool are being used productively, we recommended that Fleet should continue its efforts to establish a minimum-use requirement for the vehicles it rents to state agencies on a long-term basis and should ensure that state agencies follow the requirement or justify vehicle retention when they do not meet the requirement. Additionally, for its short-term pool, Fleet should continue to develop performance standards to better assess vehicle utilization and idle time.

General Services' Action: Partial corrective action taken.

General Services reports that in January 2006 it issued a Management Memorandum that revised the minimum vehicle use criteria for vehicles it leases to state agencies on a long-term basis. The criteria are now a minimum of 6,000 miles or 80 percent of workdays within a six-month period. General Services states that it is now using the same minimum usage standards to assess utilization and idle time of the short-term vehicle pool.

Finding #4: Fleet does not analyze its costs by vehicle type.

Fleet does not analyze its costs by vehicle type and therefore cannot readily identify vehicles that are not cost-effective to own. It is important for Fleet to understand its costs to manage the motor pool and ensure that the motor pool's composition of vehicles is not costing the State more than is necessary. Potentially, Fleet could reduce its costs by limiting the types of vehicles that it has available.

If Fleet finds that the cost of owning a specific vehicle type significantly exceeds the rate it charges, it could make decisions to align the rate with its costs. Further, if Fleet determines that owning a specific vehicle type costs more than state agencies will spend by using alternatives to the motor pool, Fleet could make decisions to eliminate or limit those types of vehicles. We recognize that the decisions Fleet makes regarding the composition of its motor pool may consider other factors, such as the needs of state agencies for particular types of vehicles. However, if Fleet analyzed its costs by vehicle type, it could better ensure that it is meeting the needs of the state agencies it serves in the most cost-effective manner.

According to its chief, as of May 2005, Fleet was working to develop a feasibility study report for a fleet management system. She expected this system to provide reports that will include information to help Fleet calculate costs by vehicle type, such as fuel use by vehicle type and repair and maintenance costs by vehicle type. The chief also told us that Fleet was in the process of incorporating additional performance measures related to costs by vehicle type to identify other opportunities for cost savings.

We recommended that to ensure that the composition of its motor pool is cost-effective, Fleet should continue its efforts to obtain costs by vehicle type. It should consider this information in its rate-setting process as well as in its comparisons to the costs of alternatives to the motor pool.

General Services' Action: Partial corrective action taken.

According to General Services, Fleet is continuing to take significant actions to obtain the necessary information to determine the actual cost of its motor pool operations and the actual usage of its motor pool. Specifically, Fleet developed a new system that provides for employee time charges to be captured in a manner that provides more useful information on tasks performed in both inspection and garage operations. In addition, General Services states that Fleet has developed management reports that identify costs by vehicle type and plans to consider this information in the development of vehicle rates and in comparisons to the costs of alternatives to the motor pool.

Finding #5: Fleet does not periodically assess the cost-effectiveness of individual garages.

Although Fleet operates several garages throughout the State, it does not periodically analyze the revenues and expenses incurred at each garage. Consequently, Fleet does not know if any of its garages are operating at a loss. In fact, Fleet's accounting system does not track most revenues and expenses for its vehicles by their respective garages. Although Fleet tracks certain revenues and expenses, such as tire sales and certain personnel costs by garage location, it does not track the revenue from vehicle rental fees and certain expenses, such as most of Fleet's depreciation, fuel, and insurance expenses, for the individual garages. Instead, Fleet tracks them in the aggregate for all garages.

With its current accounting system, Fleet can determine if its garages as a whole are operating at a break-even point, but it lacks the necessary information to determine the cost of operating each garage. Consequently, Fleet could unknowingly be operating a garage that costs more than the garage generates in revenue. Additionally, Fleet cannot use its accounting system to determine if the State would pay less if it closed one or more garages and obtained the garages' services from alternative sources. As of April 2005, Fleet was reviewing ways to modify the accounting system so that it tracks the revenues earned at each garage and provides Fleet the financial information necessary to analyze each garage.

To ensure that it does not operate garages in areas where alternative methods of transportation, such as vehicles from commercial rental companies, would be less expensive to the State, we recommended that Fleet examine individual garages to determine whether it is cost-effective to continue operating them. Fleet should consider all relevant factors, such as the frequency with which it rents vehicles on a short-term basis, the ability for other garages to take long-term rentals, and the cost-effectiveness of its repair and maintenance services.

General Services' Action: Partial corrective action taken.

General Services states that it has developed additional utilization and cost data that will assist in judging the efficiency and effectiveness of its garages. Additionally, General Services reports that Fleet has taken other significant actions to improve its ability to adequately monitor the efficiency and effectiveness of garage operations. Specifically, Fleet reorganized its garage operations and hired a new manager over those operations who has a strong background in managing fleet programs, including the gathering of data that will allow the cost-effectiveness of the individual garages to be more accurately evaluated.

Finding #6: Fleet does not measure the cost-effectiveness of its repair and maintenance services.

Fleet provides maintenance and repair services to its motor pool and agency-owned vehicles at its garages. However, Fleet does not adequately track its labor costs and therefore does not know how much it actually costs to perform each of the services it provides. As a result, Fleet cannot fully assess its competitiveness. Fleet needs to know the cost of the specific services it provides to make decisions about which services to outsource or perform in-house and which garages to close, consolidate, or expand.

Although labor represents a significant cost for Fleet's garages, Fleet does not determine how much time it spends performing various maintenance and repair services, such as changing oil or servicing transmissions. Fleet employs technicians who perform these services, but it does not require them to allocate their time to specific tasks. If Fleet tracked labor hours by task through its timekeeping system, it could use that data and the information it maintains in its fleet database to determine the labor required to perform each service. Without knowing the labor costs of its services, Fleet cannot determine if the State is spending less to perform repair and maintenance services than it would spend at commercial repair shops.

In May 2005, Fleet's chief told us that measuring its cost-effectiveness is a Fleet priority and that by September 2005 Fleet anticipated implementing a timekeeping system that would allow it to track the amount of time staff spend performing tasks. With that information, Fleet will be able to analyze which tasks it can perform more cost-effectively than commercial repair shops can and if the current ratio of in-house repairs to repairs performed by commercial repair shops is optimal.

We recommended that Fleet should continue with its plan to track the time of its garage employees by task to determine the cost of its repair and maintenance services and that Fleet should compare its costs to the amount that commercial repair shops would charge for the services.

General Services' Action: Partial corrective action taken.

General Services told us that a new system for tracking tasks was installed for use within Fleet in October 2005. According to General Services, garage staff and Fleet's asset management staff were trained and actively began using the new system in January 2006. General Services states that as sufficient historical data becomes available, the resulting information will be used within future cost-effectiveness studies.

Finding #7: Opportunities exist to improve Fleet's purchase approval process.

To ensure that state agencies do not make unnecessary vehicle purchases, state law requires Fleet to verify that the state agencies need the vehicles before it approves purchase requests. Fleet has made changes to strengthen its purchase process that have improved the amount of information that state agencies submit to justify their vehicle purchase requests; however, more changes are needed.

Until February 2003, Fleet's policy was to require an agency submitting a purchase request for one or more vehicles to explain the agency's need for the vehicles, but in practice it required no standard form or type of information for new purchases. In February 2003, Fleet introduced a standard form for vehicle purchase requests, specifically requiring state agencies to explain

their needs. After improving the form in October 2003, Fleet now requires state agencies to explain how and where the vehicle will be used; why a special vehicle, rather than a standard sedan, is required; and whether the need for the vehicle is urgent. When state agencies provide this additional information, Fleet is able to complete a more thorough, meaningful assessment of need.

Although the new form has resulted in Fleet's receiving more detailed explanations of why state agencies need to purchase vehicles, Fleet still does not require state agencies to report why any underutilized vehicles they might have cannot fulfill their needs. Consequently, if it is to make a thorough assessment of need, Fleet must follow up with the state agencies. By requiring state agencies to explain in writing why their underutilized vehicles are not adequate to meet their needs, Fleet not only would reduce the amount of follow-up it must perform but also could better ensure that state agencies consider increasing utilization of the vehicles they currently own before they request to purchase additional vehicles.

To improve its review of vehicle purchase requests and the related documentation that it receives, Fleet should continue using its new request form with an amendment requiring state agencies to explain, on the request form, why any underutilized vehicles they might have could not fulfill their requests.

General Services' Action: Partial corrective action taken.

General Services stated that it issued in January 2006 a Management Memorandum that requires state agencies requesting vehicle purchases to provide more detailed information on their underutilized vehicles as part of Fleet's acquisition request review and approval process. According to General Services, this information is to include explanations on why any underutilized vehicles that may exist cannot fulfill the agency's needs and a certification from the agency's fiscal officer that the requested acquisition is the most cost-effective solution to meet the agency's transportation needs.

Finding #8: Fleet's minimum-use requirement for state agencies may be too low.

To ensure that state agencies do not purchase more vehicles than they need, Fleet set a policy that an agency-owned vehicle must be driven at least 4,000 miles or 70 percent of the workdays every six months. A policy requiring that state-owned vehicles be driven a minimum number of miles or days is critical to ensuring that the State's vehicles are an economical method of transportation. Once a state agency owns a vehicle, the head of that agency is responsible for ensuring that it meets the minimum-use requirement. Nevertheless, if a state agency has underutilized vehicles, as defined by Fleet's policy, Fleet may not allow the agency to purchase additional vehicles.

The State's minimum-use requirement provides a level of assurance that state agencies maximize the economic potential of their vehicles. However, Fleet's policy on minimum miles is less demanding than the policies of some other governments. The National Association of Fleet Administrators, a professional society for the automotive fleet management profession, performed a survey of fleet operators in 2003 asking participants how many miles they required their vehicles to be driven in a year. On average, government respondents required vehicles to be

driven 10,000 miles each year, 25 percent more than Fleet's policy; and on average, commercial respondents required vehicles to be driven 15,000 miles, nearly 88 percent more than Fleet's policy of 4,000 miles every six months, which equates to 8,000 miles each year.

Further, Fleet could not tell us how it developed its minimum-use requirement. Its policy is the same as it was 20 years ago. Consequently, Fleet cannot demonstrate that the requirement was set appropriately or that it is still applicable. Fleet's chief told us in May 2005 that Fleet was reviewing public-sector guidelines for fleet utilization in other states nationwide and would revise the policy in the near future.

Fleet should continue with its plan to revisit its minimum-use requirement for agency-owned vehicles to determine if the minimum number of miles or days that state agencies must drive their vehicles should be higher. When doing so, Fleet should consider factors such as the cost of alternative modes of transportation and warranty periods. Finally, Fleet should document the reasons for any decisions it makes.

General Services' Action: Partial corrective action taken.

General Services reports that Fleet completed its review of minimum use requirements and in January 2006 General Services issued a Management Memorandum advising state agencies of new criteria governing the minimum use of all vehicles. The minimum-use requirements increased to a minimum of 6,000 miles or vehicle use of 80 percent of workdays within a six-month period. According to General Services, it developed the new criteria after reviewing the minimum-use requirements used by the federal General Services Administration and nine other states.

Finding #9: Fleet inadequately managed parking lot funds.

Fleet manages approximately 30 parking lots owned or leased by General Services as of May 2005 and is responsible for administering state parking policies. Through this parking program, state employees can obtain parking spaces in lots near state offices for their cars or bicycles. Fleet deposits the fees that it charges state employees for the parking spaces into its Motor Vehicle Parking Facilities Money Account (parking fund), which it draws on to operate and maintain the lots. In recent years, Fleet's inadequate management of its parking program has caused the parking fund to lose money. The parking fund experienced losses in at least two recent fiscal years (2002–03 and 2003–04), and at the end of fiscal year 2003–04 had a deficit of $1.4 million. Although various factors contributed to the fund deficit, we focused on two that were within Fleet's control.

Contributing to the parking fund's losses is an agreement that Fleet has to purchase transit passes from a vendor to shuttle people free of charge from parking lots on the perimeter of downtown Sacramento (peripheral lots) to locations nearer their work sites. This agreement costs more than the peripheral lots are capable of generating in revenue, given the current rate structure, and it makes up a significant percentage of the parking fund's total expenses. Fleet's chief told us that in the near future, Fleet intends to stop paying the entire cost of shuttling passengers to and from peripheral lots.

Another factor contributing to the parking fund's losses is Fleet's failure to collect fees from more than 400 parkers. According to Fleet's parking and commute manager, Fleet staff discovered, while investigating the parking fund's losses, that many individuals either never had or at some point stopped having parking fees deducted from their paychecks. In addition to individuals, some state agencies also had not paid fees for parking vehicles they owned in Fleet's lots. After completing a reconciliation that it started in November 2004, Fleet identified roughly 400 parkers who were actively using their parking

passes without paying. According to Fleet's parking and commute manager, the fees for those spaces amount to $24,500 per month in revenue. However, Fleet was uncertain as to how long the oversight had occurred or how many more parkers who no longer have parking passes were involved.

The chief of Fleet explained that these errors went unnoticed because Fleet maintains data on parkers in three databases and did not begin reconciling the information with the amount of fees it collected until November 2004. Fleet has developed a process to reconcile its parking database information with its revenue on a monthly basis. Such reconciliation should help detect these problems should they recur in the future.

To ensure that it does not subsidize employee parking, Fleet should continue with its plan to stop paying the full cost of shuttling parkers to and from peripheral lots. Additionally, Fleet should, to the extent possible, seek reimbursement from parkers who have not paid for their parking spaces.

To reduce the deficit in the parking fund, Fleet should continue with its efforts to reduce expenses and maximize revenues from parking facilities by promptly identifying parking spaces that become available and renting them again.

General Services' Action: Partial corrective action taken.

According to General Services, since September 1, 2005, the parking fund administered by Fleet has not been used to purchase transit passes to shuttle parkers to and from peripheral parking lots. General Services also indicates that, based upon Fleet's comprehensive evaluation of information on potential nonpaying parkers that it developed in November 2004, it identified 49 parkers as owing unpaid parking fees of about $45,000. General Services commented that, as of January 2006, each of the 49 employees had either paid their outstanding balance or established a monthly repayment plan. Further, General Services states that Fleet has implemented additional procedures to ensure that parking funds are maximized. As part of this process, Fleet is continuing to fill parking spaces the same week as they become vacant except in the peripheral lots.

PHARMACEUTICALS

State Departments That Purchase Prescription Drugs Can Further Refine Their Cost Savings Strategies

Audit Highlights . . .

Our review of the State's procurement and reimbursement practices as they relate to the purchase of drugs for or by state departments revealed the following:

- ☑ *Although the Department of General Services (General Services) generally got the best prices for the drug ingredient cost because of up-front discounts, it had the highest state cost after considering rebates, dispensing fees, co-payments, and third-party payments.*
- ☑ *The Department of Health Services' net drug ingredient cost and state cost are lower than General Services and the California Public Employees' Retirement System's (CalPERS) because it receives substantial federal Medicaid program and state supplemental rebates.*
- ☑ *Although CalPERS receives rebates through entities it contracts with to provide pharmacy services to its members, it cannot directly verify it is receiving all of the rebates to which it is entitled.*

continued on next page . . .

REPORT NUMBER 2004-033, MAY 2005

California Public Employees' Retirement System and the Department of General Services' responses from the State and Consumer Services Agency, and the Department of Health Services' response from the Health and Human Services Agency as of May 2006

Chapter 938, Statutes of 2004, required the Bureau of State Audits (bureau) to report to the Legislature on the State's procurement and reimbursement practices as they relate to the purchase of drugs for or by state departments, including, but not limited to, the departments of Mental Health, Corrections and Rehabilitation, the Youth Authority (Youth Authority), Developmental Services, Health Services (Health Services), and the California Public Employees' Retirement System (CalPERS). Specifically, the statutes required the bureau to review a representative sample of the State's procurement and reimbursement of drugs to determine whether it is receiving the best value for the drugs it purchases. The statutes also required the bureau to compare, to the extent possible, the State's cost to those of other appropriate entities such as the federal government, Canadian government, and private payers. Finally, the bureau was required to determine whether the State's procurement and reimbursement practices result in savings from strategies such as negotiated discounts, rebates, and contracts with multistate purchasing organizations, and whether the State's strategies result in the lowest possible costs. The bureau examined the purchasing strategies of the three primary departments that contract for prescription drugs—the Department of General Services (General Services), Health Services, and CalPERS. We found that:

Finding #1: In some instances, CalPERS cannot directly verify that it is receiving all of the rebates to which it is entitled.

Negotiating drug rebates is one tool available to reduce drug expenditures. Drug manufacturers typically offer rebates based on the extent to which health care plans influence their products' market share. Although CalPERS does not directly contract with drug manufacturers, it receives rebates from some entities it contracts with

☑ *In our comparison of 57 prescription drug costs across the three state departments and select U.S. and Canadian governmental entities, the Canadian entities got the lowest prices about 58 percent of the time. However, federal law strictly limits the importation of prescription drugs through the Food, Drug, and Cosmetic Act whose stringent requirements generally exclude any drugs made for foreign markets.*

for pharmaceutical services. In some instances CalPERS receives rebates under a pass-through method. In the pass-through method, the entity negotiates rebates and contracts with pharmaceutical manufacturers so that rebate payments between the manufacturer and the entity are based on historical and prospective pharmacy utilization data for all of the members of the health care plan that the entity administers. The entity then collects and passes through to plan sponsors, such as CalPERS, either a percentage or the entire amount of the rebates earned by the sponsors based on their member utilization.

Typically, these entities prohibit CalPERS from having access to any information that would cause them to breach the terms of any contract with the pharmaceutical manufacturers to which they are a party. Because CalPERS does not have access to the entities' rebate contracts with the manufacturers, CalPERS cannot directly verify that it is receiving all of the rebates to which it is entitled. According to CalPERS, this rebate practice between the entity and the manufacturer is an industry practice and is not unique to it. CalPERS intends to continue to pursue greater disclosure requirements in future contracts with its contracting entities.

We recommended that the Legislature consider enacting legislation that would allow CalPERS to obtain relevant documentation to ensure that it is receiving all rebates to which it is entitled to lower the prescription drug cost of the health benefits program established by the Public Employees' Medical and Hospital Care Act. Additonally, CalPERS should continue to explore various contract negotiation methods that would yield more rebates for the drugs it purchases and that would allow it to achieve greater disclosure requirements to verify that it is receiving all of the rebates to which it is entitled.

Legislative Action: Unknown.

CalPERS' Action: Corrective action taken.

CalPERS reports that the providers for two of its HMO plans will furnish rebate information as part of the financial statements that they regularly provide. CalPERS also stated the provider of another of its HMOs considers rebates proprietary and confidential, and the provider does not identify rebates in its financial statements. However, a pharmacy carve-out analysis, conducted by a consultant for pharmacy claims from May 2003 through April 2004, confirmed that this HMO's management of the pharmacy benefit is the most cost-effective of CalPERS' health plans. CalPERS stated that it will continue to assess this HMO's performance and management as part of its recurring rate analysis.

CalPERS also reports that it entered into a three-year contract with a new pharmacy benefits manager (PBM) for its self-funded PPO plans. The term of the contract is from July 2006 through June 2009. According to CalPERS, this contract contains extensive provisions regarding guarantees, rebates, transparency, disclosure, and cost accountability. Because CalPERS has only received the first quarterly payment of rebates and guarantees under the new contract, it cannot yet quantify the additional savings the contract will generate. However, CalPERS expects that the total rebate payment will be twice what it received under its contract with the prior PBM based on its first quarterly payment. CalPERS stated that its new contract also requires the PBM to provide a profit and loss report specific to the CalPERS account within 30 days of the end of each contract year, and allows a CalPERS representative to audit this report.

Finding #2: General Services is in the early stages of its direct negotiations with manufacturers and aims to increase its ability to reduce the net ingredient cost of prescription drugs.

Although rebates typically decreased the cost of prescription drugs for Health Services and CalPERS, General Services' net ingredient costs, drug ingredient cost minus any rebates or additional discounts, for the drugs in our sample are about the same as its costs for the drugs before any discounts or rebates. General Services says this is because it is still in the early stages of its direct negotiations with manufacturers to achieve reduced drug costs. Currently, departments purchasing drugs through General Services can obtain rebates only for one drug product class, a rebate General Services obtained through contract negotiation efforts. For that one drug product class, state agencies received at least $1.5 million in rebates for their purchases in fiscal year 2003–04.

To ensure that state departments purchasing drugs through General Services' contracts are obtaining the lowest possible drug prices, we recommended that General Services seek more opportunities for departments to receive rebates by securing more rebate contracts with manufacturers.

General Services' Action: Partial corrective action taken.

General Services reports that to obtain the best and lowest drug price, its primary strategy continues to be to negotiate price discounts upfront with the manufacturer. However, General Services notes that if rebates result in the State obtaining the best and lowest prices, they have been and will continue to be pursued.

Finding #3: Although General Services has made progress, it still needs to negotiate more contracts with drug manufacturers.

In a January 2002 report, *State of California: Its Containment of Drug Costs and Management of Medications for Adult Inmates Continue to Require Significant Improvements*, the bureau recommended that General Services increase its efforts to solicit bids from drug manufacturers to obtain more drug prices on contract. At that time, General Services had about 850 drugs on contract, but during most of fiscal year 2003–04 had only 665 drugs on contract. General Services states

that because of limited resources, it is focusing on negotiating contracts with manufacturers of high-cost drugs. However, opportunities still exist for General Services to increase the amount of purchases made under contract with drug companies.

We recommended that General Services continue its efforts to obtain more drug prices on contract by working with its contractor to negotiate new and renegotiate existing contracts with certain manufacturers.

General Services' Action: Partial corrective action taken.

General Services reports that its strategic sourcing contractor and its partners are providing support to General Services in its efforts to negotiate and renegotiate contracts with drug manufacturers. Specifically, the contractor has assisted General Services, as needed, in the negotiation of new and renegotiation of existing contracts within the atypical antipsychotic category of drugs, which make up approximately 30 percent of annual drug costs. In addition, General Services entered into two pharmaceutical contracts using its strategic sourcing methodology that should result in significant savings to the State. Namely, General Services implemented a contract with a new prime vendor responsible for distributing drugs purchased under the State's drug procurement program that it estimates will save the State $1.3 million annually. General Services also contracted with a PBM for the Department of Corrections and Rehabilitation to use to provide prescription drugs to parolees that General Services estimates will save the State an additional $3.8 million annually. However, General Services reports that its recent efforts to contract with manufacturers of gastrointestinal and anticonvulsant classes of drugs were not successful in delivering cost savings contracts.

Finding #4: General Services was not able to demonstrate that it fully analyzed how to improve its procurement process.

General Services was unable to provide documentation demonstrating that it addressed another recommendation in our January 2002 report: that it fully analyze measures to improve its procurement process, such as joining the Minnesota Multistate Contracting Alliance for Pharmacy (MMCAP) or contracting directly with a group-purchasing organization. General Services does contract with the alliance, but that contract covers only 16 percent of the drug purchases state departments made. With state departments purchasing almost half their prescription drugs at the prime vendor's price, General Services stands to reap benefits for the State by figuring out additional ways to procure prescription drugs.

General Services recognizes that it can do more to ensure that its strategies result in the lowest possible cost to the State. In September 2004, General Services hired a contractor to analyze state spending and identify opportunities to generate savings. General Services stated that, as resources become available, it intends to solicit bids to contract directly with a group-purchasing organization to determine if additional savings can be realized beyond the savings generated by the alliance.

We recommended that General Services follow through on its plan to solicit bids to contract directly with a group-purchasing organization to determine if additional savings can be realized. However, in doing so it should thoroughly analyze its ability to secure broader coverage of the drugs state departments purchase by joining MMCAP. The analysis should include the availability of current noncontract drugs from each organization being considered and the savings that could result from spending less administrative time trying to secure additional contracts directly with drug manufacturers.

General Services' Action: Partial corrective action taken.

General Services determined that an alternative method of accessing a group-purchasing organization should be assessed. It reports that this assessment will include an analysis of the benefits of joining the cooperative purchasing arrangement used by MMCAP. As part of this process, General Services is working with the alliance to identify ways of increasing value from a group-purchasing organization through enhanced reporting and formulary management activities. General Services is also working with the University of California and CalPERS to develop strategies and methods for using a group-purchasing organization. Finally, General Services plans to send a request for information to large and medium size group-purchasing organizations by early January 2007 to gather information to assist it in evaluating the pricing and services available through the alliance. If the information received indicates that additional savings or service benefits can be realized, General Services will promptly prepare and issue a request for proposals for a new method of accessing a group-purchasing organization.

Finding #5: General Services has not fully considered how to identify and mitigate obstacles to enforcing its statewide formulary.

In our January 2002 report, the bureau recommended that General Services fully consider and try to mitigate all obstacles that could prevent the successful development of a statewide formulary, such as departments not strictly enforcing such a formulary at their institutions. A drug formulary is a list of drugs and other information representing the clinical judgment of physicians, pharmacists, and other experts in the diagnosis and treatment of specific conditions. A main purpose of a formulary is to create competition among manufacturers of similar drugs when the clinical uses are roughly equal. However, the success of a statewide formulary and the State's ability to create enough competition to negotiate lower drug prices for certain products depends on how well state departments adhere to the formulary when they prescribe drugs. Although General Services has developed a statewide formulary, it has not identified the obstacles to enforcing it. General Services has not required departments to adopt a policy requiring strict adherence to the statewide formulary and does not monitor departments' adherence to the formulary. General Services does not believe its role is to enforce the formulary, but the goals of a statewide formulary in reducing drug costs cannot be realized without such enforcement.

We recommended that General Services facilitate the Common Drug Formulary Committee and Pharmacy Advisory Board's development of guidelines, policies, and procedures relating to the departments' adherence to the statewide formulary and ensure that departments formalize their plans for compliance.

General Services' Action: Corrective action taken.

General Services reports that at the Common Drug Formulary Committee's October 2005 meeting, and the Pharmacy Advisory Board's January 2006 meeting the formulary was approved. In addition, the departments of Corrections and Rehabilitation, Mental Health, and Developmental Services have provided General Services with implementation plans for the statewide formulary. Now that the statewide formulary has been implemented, General Services and the committee will begin to focus additional resources on the administrative and enforcement concerns raised in our report.

Finding #6: General Services does not have information concerning non-prime vendor drug purchases made by departments required to participate in its bulk purchasing program.

Although state law requires specific state departments to purchase drugs through General Services, our survey of various departments indicates they are not always doing so. Specifically, California Government Code requires the departments of Corrections and Rehabilitation, Developmental Services, Youth Authority, and Mental Health to participate in General Services' bulk purchasing program. In addition, California Public Contract Code requires that all state departments purchasing drugs totaling more than $100 must purchase them through General Services. California State University, the University of California, and some entities within the California Department of Veterans' Affairs are exempt from this requirement. Although we found that departments generally purchase most drugs through General Services' contract with its prime vendor, they also purchase drugs through other vendors.

Nine state entities purchased prescription drugs using General Services' prime vendor, but each of these entities also purchased drugs from non-prime vendor sources during fiscal year 2003–04. For example, although the Youth Authority purchased drugs from the prime vendor costing roughly $1.8 million, it also purchased drugs costing almost $451,000 through other vendors. Seven of the nine entities we surveyed purchased 20 percent to 100 percent of their drugs through non-prime vendor sources. General Services stated that it did not have insight into the amounts and kinds of drugs that entities were purchasing through other sources and therefore has not analyzed these purchases.

In order to make more informed decisions concerning the operation of its prescription drugs bulk-purchasing program and to be able to expand the program to include those prescription drugs that best serve the needs of state departments, we recommended that General Services ask those departments that are otherwise required to participate in the bulk purchasing program to notify General Services of the volume, type, and price of prescription drugs they purchase outside of the bulk purchasing program.

General Services' Action: Corrective action taken.

General Services reports that it now requires those departments that must participate in the bulk-purchasing program to provide it with quarterly reports on drugs purchased outside of the program. This information will aid General Services' pharmaceutical and acquisitions staff in making decisions about the bulk-purchasing program.

Finding #7: Health Services needs to improve the accuracy of its pharmacy reimbursement claim data.

Our review found that Health Services sometimes uses incorrect information when paying pharmacies. In several instances Health Services' payments to pharmacies were based on outdated or incorrect information. Health Services receives updates from a pricing clearinghouse and changes its prices monthly. One factor that Health Services uses to determine the appropriate drug price for a claim is the date of service. Specifically, Health Services uses this date to query its pricing file and identify the price in effect during the date of service on the claim. However, Health Services holds the price updates it receives from its primary reference source until the subsequent month because its budgetary authority only allows for monthly updates. Additionally, Health Services did not update its prices to reflect the elimination of the direct pricing method, which was the price listed by Health Services' primary or secondary reference source or the principal labeler's catalog for 11 specified pharmaceutical companies. Despite state law eliminating this method as of December 1, 2002, Health Services continued to use it during fiscal year 2003–04 to reimburse pharmacies. Health Services stated that the system change error related to the direct pricing method occurred prior to the July 2003 implementation of its fiscal intermediary's Integrated Testing Unit, which is responsible for performing comprehensive tests of system changes to prevent program errors. Health Services also incorrectly calculated drug prices. Although Health Services began corrective action after we brought the issues to its attention, its analyses to quantify the full extent and dollar impact of these errors was not complete as of April 2005.

To ensure that it reimburses pharmacies the appropriate amounts for prescription drug claims, we recommended that Health Services analyze the cost-effectiveness of increasing the frequency of its pricing updates. If this analysis shows that it would be cost-effective to conduct more frequent updates, Health Services should seek budgetary authority to do so. Health Services should also identify prescription drug claims paid using the direct pricing method, determine the appropriate price for these claims, and make the necessary corrections. In addition, we recommended that Health Services ensure that the fiscal intermediary's Integrated Testing Unit removes future outdated pricing methods promptly. Finally, Health Services should ensure that its fiscal intermediary's Integrated Testing Unit verifies that, in the future, drug prices in the pricing file are calculated correctly before authorizing their use for processing claims.

Health Services' Action: Partial corrective action taken.

Health Services reports that a 2005 budget health trailer bill amended the Welfare and Institutions Code to increase the frequency of drug price updates to weekly instead of monthly. Health Services began processing weekly updates in January 2006. In addition, Health Services determined that using the direct pricing method, which was eliminated by state law effective December 1, 2002, caused it to overpay 457,368 claims for a total of $2.9 million, and to underpay 199,380 claims by more than $450,000. Therefore, Health Services reports that its total net recoupment will be approximately $2.5 million for the period of December 1, 2002, through June 30, 2005. Health Services stated that its assessment of the provider impact and corrections to the pricing file must be implemented before it can move forward on this recoupment. As of early-December 2006, Health Services

was working with its fiscal intermediary to complete the corrections. Finally, Health Services has implemented safeguards within the fiscal intermediary's Integrated Testing Unit to assure that these types of errors in the pricing file will not occur on future system changes.

THE STATE'S OFFSHORE CONTRACTING

Uncertainty Exists About Its Prevalence and Effects

Audit Highlights . . .

Our review of the extent of the State's offshore contracting revealed the following:

- ☑ *No current state laws or regulations address the use of offshore contracting, making it difficult to judge the prevalence and effects of offshore contracting.*
- ☑ *Our analysis of the limited survey data suggests the State is spending little on services performed offshore:*
  - *Thirty-nine entities responding to our survey reported 185 contracts totaling $689.9 million where at least some portion of the work was possibly performed offshore.*
  - *For 109 of these contracts totalling $349 million, respondents estimated that only $9.7 million (2.8 percent) was for services performed offshore but could not provide an estimate for the remaining 76 contracts.*
- ☑ *The offshore contracts we reviewed generally contain provisions to protect sensitive and confidential information from disclosure.*

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REPORT NUMBER 2004-115, JANUARY 2005

The Joint Legislative Audit Committee (audit committee) directed us to examine the extent to which state-funded work is being contracted or subcontracted out of the country. Specifically, the audit committee asked us to review any Department of General Services' (General Services) policies and procedures relevant to offshore contracting (offshoring) and directed us to survey selected state agencies to identify those that have, or are most likely to have, contracted for services offshore during the previous three fiscal years. Further, for a sample of those agencies identified as having contracts for services offshore, the audit committee asked us to review and evaluate the agencies' policies and procedures for offshoring, including how the agency protects against the disclosure of sensitive and confidential information.

Finding #1: State agencies receive no guidance on offshore contracting.

State agencies currently receive no guidance related to offshoring and are not required to track where their contracted services are being performed or report the extent to which services are being performed offshore. As the State's contracting and procurement oversight agency, General Services oversees state purchasing, approves contracts for services, and sets contracting policies for the State. According to General Services, neither the State Contracting Manual nor any current state law or regulation specifically addresses the use of offshore contracting, the practice of subcontracting portions of a contract offshore, or the issue of determining where contracted services are performed. This lack of guidance can result in inconsistency in contract provisions among state agencies and makes it difficult to judge the effects and prevalence of offshoring.

We recommended to the Legislature that if it desires information and data on offshore contracting of state services to be more readily available, it may consider granting General Services the authority to require contractors to disclose, as part of their bid on state work or during performance of the contract, details on any and all portions of the project that subcontractors or employees outside the United States will perform.

☑ *Proposed legislation designed to place restrictions on and limit offshore contracting could face legal challenges or have unintended consequences.*

Legislative Action: Legislation vetoed.

During the 2005–06 session, the Legislature passed Assembly Bill 524 that would have required all successful bidders on state services' contracts to complete a questionnaire and report on the portions of the contract that would be performed by subcontractors or employees outside of the United States. The governor vetoed the bill on September 29, 2005.

Finding #2: The extent of state entities' offshore contracting remains unclear.

Our survey of selected state agencies and campuses (entities) gives a limited understanding of the extent of these entities' offshore contracts because, as mentioned earlier, state agencies are not currently required to collect or track data on state-funded services being performed offshore. Because of the difficulty in identifying where subcontracted work is performed, capturing with any certainty the amount of state funds spent on services performed offshore is a challenge. However, from our limited data, the State apparently has been spending little on services performed in foreign countries.

Specifically, we surveyed the 35 state agencies with the largest dollar amount of contracts for certain services and the five University of California campuses with medical centers about their use of offshoring. These entities reported 185 contracts totaling $638.9 million in which at least some portion of the work has possibly been performed offshore. Asked to estimate the dollar amount of these offshored services, entities reported that they did not know the amount for 76 of these contracts. For the remaining 109 contracts, totaling $349 million, entities estimated that only $9.7 million (2.8 percent) of the contracted services were performed offshore.

Finding #3: Previous efforts to determine the prevalence of offshoring also yielded limited results.

Three other organizations that tried to determine the prevalence of services contracted offshore also produced limited results. Specifically, General Services, in response to a February 2004 legislative directive, provided documentation detailing all the internal contracts it entered into that had work performed out of state or out of the country. General Services found that when contractors' specified work was performed offshore, the degree of offshore work was not always apparent. According to General Services, such data is extremely difficult to gather because the State currently has no requirement for state agencies to collect and track any offshore information. Additionally, a nonprofit corporate research company claims that most states cannot estimate the total amount or value of state contract offshoring because most state governments do not know where service work they contract

out is performed. Finally, the U.S. Government Accountability Office concluded that although there are anecdotal accounts of state governments using offshore contracts, no comprehensive data or studies of the extent to which state governments use these contracts are available.

Finding #4: Contract provisions related to subcontracting are not consistent among entities.

Our survey results show that state entities are inconsistent about including contract provisions related to subcontracting, delegating, or assigning contract duties. Specifically, we asked survey participants if their general contract provisions prohibit any or all of the contracted services to be subcontracted, assigned, or delegated. Eleven of the 39 entities responding reported that they generally prohibit any or all services from being subcontracted, assigned, or delegated. Another 24 responded that their contract provisions generally do allow for services to be subcontracted, and the remaining four entities did not respond to the question. Of the 24 entities that generally allow for subcontracting, four reported that their contracts generally do not require the contractor to notify the agency when subcontracting services. However, when entities do not require such notification, they are unaware of who is providing the services, making it difficult to effectively manage the contract.

Finding #5: Offshore contracts generally contain provisions protecting confidential information.

The offshore contracts we reviewed generally contain provisions to protect sensitive and confidential information from disclosure. Current state and federal laws protect an individual's confidential information, such as medical records, from disclosure. Of the 185 contracts that state entities reported as having at least some portion of the work performed offshore, we identified 11 contracts in which the contractor has access to confidential information. All 11 of these contracts contain, at a minimum, general terms that prohibit the contracted parties from disclosing sensitive and confidential information, and some specifically describe the contractor's responsibility in protecting this information. Nine of the 11 contracts allow the State to terminate the contract if the entities consider the contractor to be in material breach of the terms and conditions, including those protecting sensitive and confidential information. Finally, nine of the 11 contracts include a provision dictating that the governing law of the contract shall be the laws of the State.

General Services requires state contracts to include standard terms and conditions that subject the contract to the laws of California, including those related to confidential information, and that impose liability on the contractor for all actions arising out of the contracts. However, it is important that all parties to the contract, including all subcontractors, either domestic or offshore, are aware of these standard terms and conditions and comply with them.

Finding #6: Legislative attempts to restrict offshore contracting raise serious legal concerns.

The federal government and 40 states, including California, have proposed or adopted legislation to restrict offshoring. These include laws that would prohibit all contracts in which work is performed offshore, provides preferences to state or local vendors, require that state contracts detail and report all services performed offshore, and require disclosure if contractors send sensitive or confidential information offshore. Existing research indicates that state efforts to

restrict offshoring may violate constitutional provisions allowing the federal government to set uniform policies for the country as a whole in dealing with foreign nations. Also, restricting or limiting offshoring may invite retaliatory trade sanctions against the United States. Before proposing measures to restrict offshoring, policymakers need to consider whether such actions are both legally sound in the United States and capable of withstanding international legal challenges.

EMERGENCY PREPAREDNESS

California's Administration of Federal Grants for Homeland Security and Bioterrorism Preparedness Is Hampered by Inefficiencies and Ambiguity

Audit Highlights . . .

Our review of California's administration of federal grants for homeland security and bioterrorism preparedness revealed that:

- ☑ *The State's two annual statewide exercises have not sufficiently tested the medical and health response systems.*
- ☑ *The Governor's Office of Emergency Services (Emergency Services) and the Governor's Office of Homeland Security have been slow in spending federal grant awards for homeland security.*
- ☑ *Emergency Services is behind schedule in its receipt and review of county and state agency emergency response plans.*
- ☑ *The California Department of Health Services has not finalized its plans to conduct on-site reviews of subrecipients.*
- ☑ *The State's organizational structure for ensuring emergency preparedness is neither streamlined nor well defined.*

REPORT NUMBER 2005-118, SEPTEMBER 2006

California Department of Health Services', the Governor's Office of Emergency Services', and the Governor's Office of Homeland Security's responses as of November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the State's administration of federal grants for homeland security and bioterrorism preparedness. We were asked to determine whether state entities are administering these grants in an efficient and effective manner. Specifically, the audit committee requested that we identify the state entities responsible for homeland security and bioterrorism preparedness, their roles, and how they coordinate and communicate with each other. It also asked that we review and assess how state entities plan and train for responding to a terrorist attack and the scale or criteria the State uses to determine the seriousness of a potential terrorist attack. Additionally, the audit committee asked that we determine how state entities ensure compliance with their policies and procedures, including a review of the State's procedures for monitoring funds distributed to local entities. The audit committee further requested that we examine the State's homeland security and bioterrorism preparedness funding, expenditures, and encumbrance activities, including policies for prioritizing expenditures, how state entities have spent federal homeland security and bioterrorism preparedness funds, expenditure rates, and criteria for determining the amount of funding local entities receive from the State. Finally, the audit committee asked that we identify impediments to the efficient and effective investment of federal homeland security and bioterrorism preparedness funds. We performed most of our audit work at three state entities: the California Department of Health Services (Health Services), the Governor's Office of Emergency Services (Emergency Services), and the Governor's Office of Homeland Security (State Homeland Security).

Finding #1: Annual statewide exercises have not sufficiently tested California's medical and health systems.

Although the State has been conducting emergency exercises simulating various threats throughout the last few years, California's two major annual exercises—the Golden Guardian exercises created by State Homeland Security and the Statewide Medical and Health Disaster exercises created by the Emergency Medical Services Authority—have not exerted sufficient stress on the State's medical and health systems to determine how well they can respond to emergencies. In 2005, Golden Guardian included a simulation involving about 550 casualties suffering from moderate-to-acute injuries or who died at the scene. Because that number is at the low end of the range of 250 to 10,000 casualties estimated for a moderate-size emergency, Golden Guardian lacked sufficient realism. Also, according to one Golden Guardian participant, the exercise tested medical mutual aid from a source that would not be used during an actual emergency. Further, although the Statewide Medical and Health Disaster Exercise was designed to fulfill exercise needs for local medical and health systems, it has not tested the medical and health mutual aid systems on a statewide basis. As a result, California does not know how well its medical and health systems can respond to all emergencies.

Emergency Services is the lead agency for emergency management in California. One of the four phases of emergency management is preparedness. Exercises are a type of activity that occurs within the preparedness phase. Emergency Services raised concerns about the 2005 Golden Guardian exercise. In a February 2006 letter, Emergency Services' director stated that "inadequate integration of the [state emergency management system] by [State Homeland Security], coupled with unfocused objectives, caused exercise design flaws and problems in the exercise play." The director also noted, "local participants have stated that [Golden Guardian 2005] was confusing and frustrating and called into question the credibility of the State's level of preparedness."

To better prepare the State for responding to terrorism events and other emergencies, state entities, including State Homeland Security and Emergency Services, should ensure that future exercises are as realistic as possible and sufficiently test the response capabilities of California's medical and health systems.

Emergency Services' Action: Pending.

Emergency Services stated that stressing the medical and health systems will certainly be the focus of future statewide exercises. Further, under statutory authority as the lead emergency management agency in the State, Emergency Services is strengthening its statewide exercise program designed to test policy, plans, and procedures and its associated training program for an all-hazards concept of response and recovery. Emergency Services plans to develop an outline for the statewide exercise program by March 2007, present a final draft of the outline to stakeholders by September 2007, and implement the plan in December 2007.

State Homeland Security's Action: Partial corrective action taken.

State Homeland Security stated that it incorporated the Statewide Medical and Health Exercise into the 2006 Golden Guardian Exercise for the first time. It also stated that more than 100 hospitals participated in the 2006 Golden Guardian Exercise, which included 20,000 injuries that required hospital beds and 72,000 treated and released at the scene. State Homeland Security further stated that it will continue to test aspects of the medical health system in the next Golden Guardian exercise and that it will use a variety of exercises to test the medical system, including tabletop, functional, and full-scale exercises. Finally, State Homeland Security stated that it will build on previous and current Golden Guardian efforts as part of future planning.

Finding #2: California's spending of some federal funds has been slow.

The State has not promptly spent federal funds received since 2001 for homeland security. As of June 30, 2006, Emergency Services and State Homeland Security had spent only 42 percent of the funds granted to the State for homeland security. The slow pace of spending of the homeland security funds is a sign that California may not be as prepared as it otherwise could be. Local entities we contacted offered several reasons for the slow spending, including the State's slow process for reimbursing local entities. To determine the length of time it took the state to process reimbursement requests, we examined samples of payments made at two points during 2006. Our review of the first sample showed that it took Emergency Services and State Homeland Security an average of 66 days to process reimbursement requests. For the second sample, it took the two entities an average of 41 days. Based on the results of our testing, the State's current reimbursement process probably does not contribute significantly to the inability of subrecipients to spend federal grants. However, both averages exceed the 30-day maximum established in law for state entities to process invoices from its contractors. We believe this is a reasonable benchmark. Local entities also mentioned the combination of the short time allowed for developing budgets and the time-consuming budget-revision process as obstacles, and identified local impediments to quicker spending, including procurement rules and a lack of urgency.

To identify steps that could be taken to help increase the pace of spending for federal homeland security grants, State Homeland Security should create a forum for local administrators to share both best practices and concerns with state administrators. Further, to reduce the amount of time necessary to reimburse local jurisdictions for their homeland security expenditures, State Homeland Security and Emergency Services should collaborate to identify steps they can take.

Emergency Services' Action: Partial corrective action taken.

Emergency Services stated that it and Homeland Security are working cooperatively and are committed to reducing the processing time for all reimbursement claims. It also indicated that, although it is currently processing payments within 35 to 40 days, its goal is to reduce the processing time down to 30 days.

State Homeland Security's Action: Partial corrective action taken.

State Homeland Security stated, among other things, that it will continue to create forums for local administrators to share best practices and concerns with the State. State Homeland Security cited the expansion of its Program and Capability Review (PCR) from 200 participants to as many as 1,000 as an example. State Homeland Security stated that during the PCR, local administrators will have time to discuss grant issues and other types of issues with counterparts from around the State. It will also include best practices workshops as part of the PCR. State Homeland Security also mentioned that it will host an annual statewide conference in early spring 2007 at which it will encourage the sharing of best practices by giving local agencies the opportunity to explain what has worked for them and some of the problems they encountered along the way.

Regarding steps to reduce the time necessary to reimburse local jurisdictions, State Homeland Security indicated that it has been working with Emergency Services to coordinate activities. It also stated that it will implement a process for getting payments to Emergency Services' accounting office within 15 days and, to help achieve this goal, it will create and fill an additional payment processing position.

Finding #3: State reviews of emergency response plans are behind schedule.

The state emergency plan and other existing emergency and mutual aid plans guide public entities during their response to declared emergencies, in conjunction with the emergency operations plans established by local governments and state agencies. Emergency Services, however, is behind schedule in its receipt and review of the emergency operations plans for 35 of California's 58 counties and those of 17 of 19 state entities that are key responders during emergencies. As a result, California cannot ensure that these plans incorporate all relevant changes in agency reorganizations, new laws, and experience with both exercises and actual disasters. California also has less assurance that these plans will effectively guide the entities in their response to emergencies. The current status of the State's review of local and state agency plans is the result of weak internal controls.

To ensure that emergency plans of key state entities and local governments are as up-to-date as possible, integrated into the State's response system, and periodically reviewed, Emergency Services should develop and implement a system to track its receipt and review of these plans.

Emergency Services' Action: Partial corrective action taken.

Emergency Services stated that it will include the emergency planning process as part of its effort to update the state emergency plan. The revised state emergency plan will define the update schedule for the State's plan and define the supporting plans and their update schedule. Emergency Services estimates that the completion date for the updated state emergency plan is January 2008.

Emergency Services also stated that it is completing a database to include the emergency-related plans and other documents for state agencies and operational areas. It stated that it will work with state agencies and operational areas to enter the information into the database. It also stated that it will assign staff to oversee the database, notify entities of the need for upcoming updates, and monitor development of emergency plans. Emergency Services has set a target date of January 2007 for the completion of this database.

Finding #4: Grant monitoring efforts are expanding.

Current efforts by the State to monitor subrecipients' use of homeland security and bioterrorism preparedness funds appear to comply with the minimum requirements set by the federal government. Generally, the State performs the four types of monitoring suggested by federal guidance: technical assistance, desk reviews, independent audit reports, and on-site monitoring. However, only State Homeland Security performs on-site reviews to examine subrecipients' use of federal grant funds. Legislation enacted in July 2005 requires Health Services to begin reviewing subrecipient cost reports by January 2007. Planning documents indicate that Health Services intends to perform these reviews on site. Health Services was continuing with its planning efforts as of August 2006.

To ensure that it can implement in January 2007 the provisions of Chapter 80, Statutes of 2005, related to auditing cost reports from subrecipients of federal bioterrorism preparedness funds, Health Services should complete its planning efforts.

Health Services' Action: Partial corrective action taken.

According to Health Services, it remains on schedule to implement auditing of subrecipients. Health Services told us that audit instruments have been developed and staff will initiate audits in January 2007.

Finding #5: The State's preparedness structure is neither streamlined nor well defined.

Although California's structure for responding to emergencies is established in state law and is very streamlined, its structure for preparing for emergency response is a labyrinth of complicated and ambiguous relationships among myriad entities. Emergency Services and State Homeland Security, as well as the numerous committees that provide advice or guidance to the three state entities that administer federal grants for homeland security and bioterrorism preparedness, are working within a framework of poorly delineated roles and responsibilities. If this status continues, the State's ability to respond to emergencies could be adversely affected. It appears that the current structure for preparedness arose as the State reacted administratively to guidance from the federal government and created its own requirements to fill perceived needs.

To simplify and clarify California's structure for emergency response preparation, the following steps should be taken:

- The governor and the Legislature should consider streamlining the preparedness structure. For instance, they should consider establishing one state entity to be responsible for emergency preparedness, including preparedness for emergencies caused by terrorist acts.

- The Legislature should consider statutorily defining the preparedness structure in law.

- The Legislature should consider statutorily establishing State Homeland Security in law as either a stand-alone entity or a division within Emergency Services. Further, if it creates State Homeland Security as a stand-alone entity, the Legislature should consider statutorily defining the relationship between State Homeland Security and Emergency Services.

Legislative Action: Legislation proposed.

As of December 8, 2006, we are aware of only one bill that addresses our recommendations. On December 4, 2006, Assemblymember Nava introduced AB 38 to transfer State Homeland Security from the Governor's Office to become a division within Emergency Services. Further, Emergency Services told us that it was working with the legislative leadership to determine how to best structure the relationship between it and State Homeland Security in state law. We are unaware of other actions taken by the Legislature to address our recommendations.

DEPARTMENT OF INDUSTRIAL RELATIONS

Investigations of Improper Activities by State Employees, January 2006 Through June 2006

INVESTIGATION I2006-0708 (I2006-2), SEPTEMBER 2006

Department of Industrial Relations' response as of September 2006

Investigative Highlight . . .

Used bereavement leave for work missed while incarcerated.

We investigated and substantiated an allegation that a Department of Industrial Relations (Industrial Relations) employee improperly used bereavement leave.

Finding: An Industrial Relations' employee used bereavement leave while she was in jail.

An employee charged and received payment for 16 hours of bereavement leave on her official time report and cited the death of her aunt as the reason for her absence. However, public records show that the employee was incarcerated in a Los Angeles County jail for those two days. By charging bereavement leave for hours she missed due to her incarceration, the employee improperly claimed and received $282 for 16 hours she did not work, in violation of state law.

Industrial Relations' Action: Corrective action taken.

Industrial Relations served the employee with a five-day suspension without pay. In addition, Industrial Relations set up an accounts receivable to recover the 16 hours of pay that was improperly charged as bereavement leave.

DEPARTMENT OF INDUSTRIAL RELATIONS

Its Division of Apprenticeship Standards Inadequately Oversees Apprenticeship Programs

Audit Highlights . . .

Our review of the Department of Industrial Relations' (department) Division of Apprenticeship Standards' (division) oversight of apprenticeship programs (programs) found that:

- ☑ *The division suspended program audits in 2004 and did not follow up on corrective action related to audits it had started.*
- ☑ *The division has not resolved apprentice complaints in a timely manner, taking over four years in some cases to investigate the facts of complaints.*
- ☑ *The division has not adequately monitored the apprentice recruitment and selection process. In particular, it has not conducted Cal Plan reviews since 1998.*
- ☑ *Division consultants did not consistently provide oversight through attendance at committee meetings.*

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REPORT NUMBER 2005-108, SEPTEMBER 2006

Labor and Workforce Development Agency's response as of November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the apprenticeship programs (programs) regulated by the Division of Apprenticeship Standards (division) and the California Apprenticeship Council. Specifically, the audit committee asked us to review and evaluate the laws and regulations significant to the programs and to identify the roles and responsibilities of the various agencies involved in them. It also asked us to determine the type of data collected by the division for oversight purposes and the extent to which it uses the data to measure the success of the programs and to evaluate the division's performance/accountability measures. In addition, the audit committee asked us to examine data for the last five fiscal years regarding the programs' application, acceptance, enrollment, dropout, and graduation rates, including the rates for female and minority students, and the programs' graduation timetables. Further, the audit committee asked us to review the extent and adequacy of the division's efforts related to recruitment into state-approved programs, and to identify any potential barriers to student acceptance into the programs. The audit committee wanted to know whether the division's management and monitoring practices have complied with relevant statutory requirements and whether the division has taken action against programs that do not meet regulatory or statutory requirements. Finally, the audit committee asked us to review the program's funding structure to determine whether employer contributions to programs reasonably relate to the costs of providing training. In our review, we noted the following findings:

Finding #1: The division suspended program audits in 2004 and did not follow up on corrective action related to audits it had started.

Although state law required it to begin randomly auditing approved programs during each five-year period beginning January 1, 2000, the division did not complete the audits it started, and it stopped

- ☑ *The division's staffing levels have not increased in step with legal obligations, and it has failed to document priorities for meeting these obligations for existing staff.*
- ☑ *The division did not report annually to the Legislature for calendar years 2003 through 2005, and the annual reports contain grossly inaccurate information about program completion.*
- ☑ *The department is slow to distribute apprenticeship training contribution funds. Only $1.1 million of the roughly $15.1 million that had been deposited into the training fund by June 30, 2005, has been distributed as grants.*
- ☑ *The division does not properly maintain its data on the status of apprentices.*

conducting audits in February 2004. Program audits are the means by which the division can ensure that the committees, which sponsor the programs, are following their state-approved standards and they allow the division to measure programs' success.[1] The division chief, appointed in 2006, said he was told there had been insufficient staff to complete the audits, however, he indicated that the division planned to resume audits consistently in October 2006. A comprehensive audit plan that subjects all programs to possible random audits, gives priority to auditing programs with known deficiencies, and targets programs with a high risk profile would maximize the use of the division's limited audit resources. Until the division resumes its audits and ensures that the committees correct any weaknesses in their programs, it will have difficulty measuring the success of the programs and the quality of the training apprentices receive.

We recommended that the division follow through on its planned resumption of audits of programs and ensure that recommendations are implemented and that audits are closed in a timely manner. Additionally, the division should request that the Legislature amend auditing requirements to allow it to select programs for audit using a risk-based approach.

Division's Action: Partial corrective action taken.

The division stated that it has filled its consultant and field support vacancies and will begin audits in late November 2006. It indicated that the division will primarily use a risk-based approach to select programs to audit, choosing programs whose graduation rates are less than 50 percent of the average rate for their trade. In addition, the division will select one program randomly from the remaining population for every five programs chosen under the risk-based approach. The division stated it will consider legislation during the 2007 legislative session to clarify audit requirements and the selection process.

Finding #2: The division has not resolved apprentice complaints in a timely manner or adequately monitored the apprentice recruitment and selection process.

State regulations require the director of the Department of Industrial Relations (department) to receive, investigate, and decide on complaints filed by apprentices. However, until recently the division did not consistently track these complaints. As a result, it did not

[1] Apprenticeship program sponsors—joint apprenticeship committees, unilateral labor or management committees, or individual employer programs—submit to the division an application for approval of their programs, along with proposed program standards and other relevant information. Because committees were the program sponsors for more than 97 percent of all active apprentices as of December 31, 2005, we refer to program sponsors as committees throughout the report.

review, investigate, and issue decisions in a timely fashion. Although there is no regulatory or statutory time limit for the division to investigate and resolve apprentice complaints, a time period of more than two years—and more than four years in some cases—to investigate the facts of a complaint seems excessive. Most of the complaints we reviewed that remained open in June 2006 related to allegations of unfair cancellation or suspension of an apprentice from a program. In these situations, a timely determination is critical because apprentices who were unfairly canceled are unable to become journeymen in their chosen field.

Furthermore, the division has not conducted adequate oversight of the committees' apprentice selection procedures to ensure that they promote equality of opportunity in state-approved apprenticeship programs. State regulations require committees to submit their apprenticeship selection standards to the division for approval. Among other things, the standards include provisions the committees use for determining the qualifications of apprentice applicants and uniform procedures for assuring the fair and impartial selection of applicants. State regulations also require the State of California Plan for Equal Opportunity in Apprenticeship (Cal Plan) to be incorporated into the standards. However, the division exercises limited oversight over the implementation of the committees' selection procedures. Its division chief stated that the division has not conducted systematic reviews of apprenticeship programs, also known as Cal Plan reviews, since 1998 due to insufficient staff. Consequently, the division cannot determine the extent to which committees comply with their Cal Plans. Finally, state law requires the division to coordinate the exchange of information on available minorities and women who may serve as apprentices. The division's failure to monitor selection processes makes it nearly impossible to determine whether committees are adhering to equal opportunity requirements or to identify potential barriers for women and minorities.

We recommend that the division work with the department's legal division to establish time frames for resolving complaints and develop a method for ensuring that complaints are resolved within the time frames. Also, the division should require committees and their associated third-party organizations to maintain documentation of their recruitment and selection processes for a time period consistent with Cal Plan requirements and should conduct systematic audits and reviews of apprenticeship recruitment and selection to ensure compliance with Cal Plan requirements and state law. Finally, the division should develop a process for coordinating the exchange of information on available minority and female apprentices.

Division's Action: Partial corrective action taken.

The division said that complaints have been assigned to one individual in the headquarter's office and that the status of complaint processing is reviewed each week during standing meetings with the division chief. Further, the division and the department's legal division have developed a communications process to ensure that complaints are processed timely. The division believes that once the current backlog is processed, the volume of complaints should be relatively low and manageable.

The division indicated that it intends to conduct Cal Plan reviews of each program once every three years and that its review of the first one-third under the new system is nearly complete. The division stated that these reviews found many programs that will need to update their standards and will require a follow-up review in 2007. The division did not address the recommendation related to coordinating the exchange of information on available minority and female apprentices.

Finding #3: Division field offices can improve their oversight of the committees and the division has not documented priorities for existing staff.

Consultants working in the division's field offices can improve their oversight of the committees. A key role of the division's consultants, each of whom oversees an assigned group of committees, is to attend committee meetings, especially if an apprentice is to appear before a committee. Despite the stated importance of the consultants' attendance at committee meetings, our review of files at six field offices found that consultants did not consistently attend these meetings. The field offices also lack a formal, centralized process for tracking the resolution of issues or questions that may arise at committee meetings or during the normal course of business. Further, the consultants do not consistently enforce regulations requiring committees to complete self-assessment reviews and program improvement plans. Finally, although state regulations allow the division chief to cancel programs that have had no active apprentices for two years, until recently the consultants had not consistently identified inactive programs. Maintaining an up-to-date list of apprenticeship programs is important because the division can use it to more evenly prioritize and distribute the number of committees each of its consultants is responsible for, improving their ability to monitor their committees.

The division chief indicated that a lack of staff has prevented the division from completing its monitoring requirements. His priority for 2006 was to focus on customer service and to improve the division's processes to enable staff to meet requirements in a timely and accurate manner; his priorities for 2007 are to focus on promotion and expansion of apprenticeship into trades not typically associated with apprenticeship, and to ensure the quality of programs through consistent implementation of oversight activities.

We recommended that the division document specific priorities and goals for its staff both to maximize the use of existing staff and to identify additional staffing needs. We also recommended that the division require its consultants to enforce regulations that call for committees to submit self-assessment reviews and program improvement plans.

Division's Action: Corrective action taken.

The division stated that it has established goals, strategies, and standards, which have been communicated to staff. In addition, the division has developed performance measurements for the standards. Finally, the division has set priorities related to oversight activities including attendance at committee meetings; focused site visits; and ensuring the completion of self-assessment reviews, program improvement plans, program audits, and Cal Plan reviews.

Finding #4: The division does not adequately track and disseminate information to the Legislature as state law requires and the department is slow to distribute apprenticeship training contribution funds.

State law requires the division chief and the California Apprenticeship Council to report annually to the Legislature and the public on their activities. According to its chief, the division did not do so for calendar years 2003, 2004, and 2005, thus missing the opportunity to make the Legislature aware of the apprenticeship programs and gain valuable feedback on the direction of the programs. The annual reports that have been prepared also contain grossly inaccurate information about the number of apprentices that complete the program due to a programming error.

Furthermore, although state law mandated the department to begin distributing grants to programs from the apprenticeship training contribution fund (training fund) in 2003, it did not distribute its first grants until May 2006. The department has had the authority to spend $1.2 million on grants in each of the last three fiscal years. Its budget officer attributes part of this delay to a lack of regulatory authority on how to calculate the grant amounts.

While the department has distributed $1.1 million in grants as of June 2006, it has spent significantly more on division operations. As of June 30, 2005, about $15.1 million had been deposited into the training fund. During fiscal years 2001–02 through 2004–05, the division used a total of $4 million from this fund to pay for salaries, benefits, and other costs. Additionally, during fiscal years 2002–03 and 2003–04, a total of $2.8 million was transferred from the training fund to the State's General Fund. Consequently, the June 30, 2005, fund balance was $8.3 million. Clearly, the use of $4 million primarily for general division expenses prior to the distribution of grants adversely affects the division's ability to fund grants to committees because less cash is available to support increases in spending authority for grants and subsequent grant distributions.

We recommended that the division ensure that it submits annual reports to the Legislature that are accurate, timely, and consistent with state law. We also recommended that the department request increased budgetary authority as necessary to distribute apprenticeship training contribution money received each fiscal year and the training fund balance as grants to applicable programs. If the department believes that amounts collected from employers for deposit into the training fund should be used to fund division expenses at the same priority level as grants to apprenticeship programs, the department should seek statutory changes that clearly reflect that employers are also funding general expenses.

Department's Action: Partial corrective action taken.

The division stated that a report for 2003 through 2005 will be posted on its Web site once the administration has approved it and the Legislature receives it. In addition, the division has created an annual calendar that includes a task for submitting the report in July of each year.

The division said that $1.2 million in grant distributions for fiscal year 2006–07 is in process and that it will use appropriate budget mechanisms to increase distributions as justifiable. The department believes that it has the legal authority to use the money deposited in the training fund for purposes beyond the cost of administering the processing of checks and distribution of grants. Therefore, it does not believe that additional statutory changes are necessary.

Finding #5: Information in the division's database could be used to oversee programs, if better maintained.

Because the division does not properly maintain its data on the status of apprentices, it cannot determine actual program performance, such as the rate at which apprentices cancel or complete their apprenticeships. Field office staff are responsible for updating and verifying the information entered in the database; however, according to a few of the consultants, staffing limitations prevent them from performing this function on a regular basis. Thus, the division's deputy chief, on a case-by-case basis, sends committees an electronic listing of active apprentices in their programs and asks them to update the information, which he then uses to update the database. A standardized process for updating the database on a regular basis could help increase the accuracy of the information it contains. If accurate, the division could use this information to set performance goals, pinpoint program successes and failures, and focus its monitoring efforts.

We recommended that the division establish a process for regularly reconciling information on the current status of apprentices with information maintained by committees and use data to set performance goals and to pinpoint program successes and failures.

Division's Action: Pending.

The division stated that it and two software vendors are testing a new electronic data interchange function for the initial and recurring synchronization of apprentice records. It expected to have this feature available for all programs with the software by the end of 2006. The division will create a web-based program for those programs without apprenticeship management software.

SAN FRANCISCO-OAKLAND BAY BRIDGE WORKER SAFETY

Better State Oversight Is Needed to Ensure That Injuries Are Reported Properly and That Safety Issues Are Addressed

Audit Highlights . . .

Our review of safety oversight on the Skyway project of the San Francisco-Oakland Bay Bridge East Span replacement revealed the following:

- ☑ *The Division of Occupational Safety and Health (division) of the Department of Industrial Relations did not discover the potential underreporting of alleged workplace injuries and an alleged illness on the Skyway because it lacks procedures to ensure the reasonable accuracy of employer's annual injury reports.*
- ☑ *The division failed to adequately follow up on three of the six complaints received from Skyway workers, including an April 2004 complaint in which it found two alleged serious violations but did not issue citations to the contractor.*
- ☑ *The California Department of Transportation's safety oversight of the Skyway appears sufficient but improvements, such as increasing safety training and meeting attendance, could be made.*

REPORT NUMBER 2005-119, FEBRUARY 2006

Department of Industrial Relations' and the California Department of Transportation's responses as of August 2006

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to evaluate the Department of Industrial Relations' (department) Division of Occupational Safety and Health's (division) enforcement of worker safety and health laws and the California Department of Transportation's (Caltrans) oversight practices on construction of the East Span of the San Francisco-Oakland Bay Bridge (East Span).

In addition, the audit committee asked us to compare the number of injuries reported by workers on the East Span with the number reported on other large construction projects. The audit committee also asked us to evaluate the workplace safety policies, including any safety bonus programs of companies contracted to work on the East Span, and determine whether any disciplinary action has been taken against workers complaining of injuries or health issues. We focused our review on the safety of workers involved in construction of the Skyway project because it is the largest, most expensive component of the East Span currently being constructed and was at the center of certain media allegations. The Skyway is a section of the new East Span stretching most of the distance from Oakland to Yerba Buena Island.

Finding #1: The division does not exercise sufficient control over the injury reporting process to ensure that employers properly report injuries.

Although the reported injury rate of the prime contractor for the Skyway project is one-fourth that of the injury rate of similar projects, we question whether relying upon these statistics as an indication of project safety conditions is justified. The federal Occupational Safety and Health Administration's (federal OSHA) Form 300: Log of Work-Related Injuries and Illnesses (annual injury report), which employers are required to complete, summarizes the workplace injuries as defined in regulations, occurring during the year and is the basis for the calculation of injury rates. The acting chief of the division explained that division investigators review annual injury reports and

may ask employees about injuries as part of on-site inspections, but the division does not collect these reports and it does not have a systematic process to detect injuries that go unrecorded. In addition, the acting chief stated that because the resources of the division are finite, a decision to invest resources into the policing of the recording of injuries in the annual injury reports necessarily means that other resource-dependent activities will suffer. Consequently, the division was not aware of a number of alleged workplace injuries and an alleged illness that potentially meet recording requirements but were not included in annual injury reports of the Skyway's prime contractor.

To identify the underreporting of workplace injuries and to help ensure the reasonable accuracy of annual injury reports, we recommended that the division develop a mechanism to obtain employers' annual injury reports and design procedures to detect the underreporting of workplace injuries. If the division believes it does not have the resources necessary to undertake this task in light of its other priorities, it should seek additional funding from the Legislature for this effort. In designing these procedures, the division should take into account conditions that may attribute to the underreporting of injuries.

Division's Action: None.

The division has concluded that developing a mechanism to obtain and review employers' annual injury reports to detect the underreporting of workplace injuries would be impossible without having an electronic information management system. Further, it believes that the site investigation needed to establish a violation based on such a review would be time consuming. Using its recent investigation of the Skyway's prime contractor, Kiewit/FCI/Manson, a joint venture (KFM), as an example, the division indicates the investigation required over 400 hours of an inspector's time as well as managerial and legal review to prove that violations occurred. Even if it does cite an employer for violations, the division believes that the citations would likely be appealed, which will consume additional, substantial resources. The division also states that stakeholders at an April 2006 meeting of the Cal/OSHA Advisory Committee (advisory committee) concluded that reviewing employers' annual injury reports for the underreporting of workplace injuries would not be in the best interest of the division. Thus, rather than developing a proactive approach to detect the underreporting of injuries that we recommended, the division indicates it will continue to focus its resources on hazard abatement and direct intervention to prevent injuries and illnesses to workers. However, despite its concerns and inaction on our recommendation, the division indicates it is working with the two other department divisions on the feasibility of electronically receiving employer's reports of injury and possibly physician's reports of injury, which would facilitate an automated review of these reports for targeting employers for review.

Finding #2: The division did not follow up adequately on all Skyway complaints.

The division did not adequately follow up on three of the six complaints received from Skyway workers. In one instance, it chose to review an April 2004 complaint from former KFM employees, using the compliance assistance approach outlined by its informal partnership agreement with KFM. Because the agreement precluded issuing citations if KFM promptly abated hazardous conditions, the division did not issue citations that otherwise are required when it found two alleged serious violations of health and safety regulations while investigating this complaint. In another instance, because of internal miscommunication, the division failed to investigate a complaint at all. Finally, despite state law requiring it to conduct on-site investigations for employee complaints having a reasonable basis, the division decided to use its nonemployee complaint procedure to handle a complaint it received from a KFM employee.

We recommended that if the division believes it will use the partnership model in the future, it should create a plan for how it will operate under the model so its activities will provide appropriate oversight and be aligned with state law. Specifically, it should ensure that roles and responsibilities are communicated clearly and that critical information is shared with all relevant individuals.

Division's Action: Partial corrective action taken.

The division also discussed the continued use of the partnership model with the advisory committee. This discussion concluded that the division would attempt to keep as clear a separation as feasible between enforcement staff and compliance assistance staff when using the partnership model. Using its recent involvement with flavoring manufacturers located in California, the division indicates offering the manufacturers a consultative inspection in lieu of an enforcement inspection, with separate units performing these functions. The division's discussion with the advisory committee did not conclude that there was a need for a plan for how it will operate under the partnership model. In addition, the division states it will keep the advisory committee informed on emerging partnerships and seek its input on significant issues.

Finding #3: Caltrans' safety oversight on the Skyway project appears sufficient, but improvements could be made.

Although Caltrans worked to implement the safety oversight procedures required by its policies on the Skyway project, some improvements can be made to better emphasize safety. For example, the project safety coordinator's position within the organization has limited independence from construction managers. In addition, because Caltrans' inspectors observe the safety conditions of the work site while monitoring the construction and engineering aspects of KFM's work, it is important that they are able to identify unsafe conditions. To do so, Caltrans' policy and state regulations require that construction personnel attend safety meetings every 10 working days and attend general and job-specific hazard training. However, our review of the attendance records for a sample of Caltrans' staff assigned to the Skyway project, including all seven construction managers who set an example for staff, indicated they have attended only 76 percent of safety classes identified as necessary for their jobs and only 66 percent of mandatory biweekly safety sessions.

To ensure that the project safety coordinator assigned to the Skyway project has the necessary independence and authority to evaluate and report on project safety, we recommended that Caltrans make this position be independent of the managers whose safety performance the coordinator must oversee. In addition, we recommended that Caltrans should ensure its construction managers and staff on the Skyway project attend the mandatory biweekly safety sessions and other necessary safety training.

Caltrans' Action: Corrective action taken.

Caltrans indicates establishing a safety coordinator position that is responsible for overseeing employee and contractor safety on the East Span's construction projects. To provide for the position's independence, the position will submit safety reports to the East Span's construction manager, but a safety manager from Caltrans' District 4 office will supervise the position. An individual was hired for the position in October 2006. Caltrans also reports taking steps to improve attendance at required safety meetings and training, and indicates that employees' attendance has improved.

JUDICIAL COUNCIL OF CALIFORNIA

Its Governing Committee on Education Has Recently Proposed Minimum Education Requirements for Judicial Officers

Audit Highlights . . .

Our review of the Judicial Council of California's (Judicial Council) training programs for judicial officers revealed:

- ☑ *Current education requirements apply only to new judicial officers and those hearing certain types of cases.*
- ☑ *The Judicial Council's governing committee on education recently proposed a Rule of Court that includes minimum education requirements for judicial officers; however, judicial officers have questioned the proposal.*
- ☑ *The Legislature does not appropriate funding specifically for judicial education; rather, the Judicial Council and the Administrative Office of the Courts allocate funds for this purpose.*
- ☑ *Expenditures we tested for the period July 2004 through December 2005 were for appropriate and allowable purposes.*

REPORT NUMBER 2005-131, AUGUST 2006

The Judicial Council of California's Administrative Office of the Courts' response as of November 2006

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to review and assess how funds appropriated to the Judicial Council of California (Judicial Council) are used for training judicial officers and to determine the processes and practices used in developing the budget for training judicial officers. We were asked to determine the amount appropriated and spent for training judicial officers over the last three years and to review the purposes and appropriateness of those costs. Finally, the audit committee asked us to review and assess management controls to ensure that funds appropriated for training are used for allowable activities and to select a sample of costs to determine whether they were valid. Specifically, we found:

Finding #1: The Judicial Council's governing committee on education recently proposed minimum education requirements for judicial officers.

The Judicial Council has authorized the governing committee that advises the Judicial Council on education with developing and maintaining education programs for the judicial branch. Additionally, the Judicial Council has authorized the Education Division of the Administrative Office of the Courts (AOC) with implementing the governing committee's comprehensive education program. The Education Division offers training to judicial officers in several legal areas; however, the majority of education programs are not required and judicial officers generally participate in most training at their own discretion. In fact, current requirements established by California Rules of Court and state law apply only to initial education for new judicial officers and initial and continuing education for those hearing certain types of cases. Further, although these judicial officers are required to attend certain courses, the AOC is generally not responsible for tracking or enforcing compliance with the education requirements. Rather, it is the responsibility of each judicial officer and court to ensure that the requirements are followed.

In fact, the Education Division generally cannot identify the individual judicial officers for which a specific training course applies because it does not track judicial officer assignments. At our request the Education Division compiled records demonstrating the number of newly appointed or elected judicial officers in the State for July 2002 through mid-April 2006, and we noted that although nearly all that we reviewed attended the required education programs, some did not do so within the required time.

Additionally, in February 2003 the governing committee began to review the concept of mandatory education and consider whether to submit a proposal to the Judicial Council on minimum education requirements for all judicial officers. As part of its process, the governing committee reviewed other state education models, assessed judicial officers' attendance at programs offered by the Education Division, considered prior efforts to establish minimum education requirements, and surveyed judicial officers in California.

Subsequent to that review process, the governing committee proposed a Rule of Court that included minimum education requirements for judicial officers. The proposed rule generally called for 30 hours of continuing education for all judicial officers in a three-year cycle, or 10 hours per year and required judicial officers to maintain records showing compliance with the requirements. Judicial officers questioned the governing committee's proposal, including the Judicial Council's constitutional authority to establish minimum education requirements. In October 2006 the Judicial Council adopted an alternate proposal that made some revisions to the governing committee's proposal in that the new Rules of Court provide that judges are expected to, and commissioners and referees must, complete 30 hours of continuing education in a three-year cycle.

We recommended that the Judicial Council implement a plan to ensure that there is a system for tracking participation to meet judicial education requirements and that the records kept are accurate and timely.

Judicial Council's Action: Partial corrective action taken.

The Judicial Council reported that the newly adopted Rules of Court require judicial officers to maintain records that show participation in judicial education. Additionally, the Judicial Council stated that these rules require each court to track commissioners' and referees' participation in education and completion of the minimum education requirements. Further, each presiding judge is required to retain judges' records of participation, which will be subject to periodic audit by the AOC. The presiding judge must report the data from these records on an aggregate basis to the Judicial Council, on a form provided by the Judicial Council, within six months after the end of each three-year period. The Judicial Council reported that the Education Division will be responsible for implementing this recommendation and developing the form that presiding judges will use to track judges' participation in judicial education.

Finding #2: The Education Division is in the midst of a lengthy process to change its approach to providing education programs.

The Education Division currently uses an event-based method of prioritizing and planning its education programs. According to the director of the Education Division, event-based planning is a method that focuses on filling a designated time slot with a training event that is recreated each time the event is planned. However, in 2000 the Education Division began a formal curriculum development process that will form the basis of a method for developing and planning its education

programs. The Education Division believes this curriculum-based approach, anticipated for completion within a few years, is more stable and can be designed to target specific audiences at entry, intermediate, or advanced career levels.

We recommended that the Education Division continue its efforts in designing curricula to use in developing its judicial education programs. Further, we recommended that, after implementing the curriculum-based planning approach, the Education Division should formally assess whether it has been successful.

Judicial Council's Action: Partial corrective action taken.

The Education Division reported that it is continuing its efforts in designing curricula to use in developing its judicial education programs and is implementing an evaluation process that includes an initial review of each new program developed. Further, the Education Division stated that, beginning in 2007, it plans to conduct an annual review of all program offerings to ensure the goals of the curriculum-based approach are met.

DEPARTMENT OF JUSTICE

The Missing Persons DNA Program Cannot Process All the Requests It Has Received Before the Fee That Is Funding It Expires, and It Also Needs to Improve Some Management Controls

Audit Highlights . . .

Our review of the Department of Justice's Missing Persons DNA Program (missing persons program) revealed the following:

- ☑ *Created in January 2001, the missing persons program reached full operation in July 2004, which appears reasonable considering the issues it faced in establishing operations.*
- ☑ *As of February 2005, the missing persons program had received 799 requests and completed DNA analysis for 261 of them, but is unlikely to complete testing for all requests before the fee supporting it expires.*
- ☑ *It may be too soon to decide whether the existing fee supporting the missing persons program should be made permanent.*
- ☑ *Several elements of the missing persons program are sound, but its management information and timekeeping databases, which could otherwise serve as valuable management tools, include inaccurate data.*

continued on next page . . .

REPORT NUMBER 2004-114, JUNE 2005

Department of Justice's response as of June 2006

The Joint Legislative Audit Committee requested the Bureau of State Audits to assess the Missing Persons DNA Program (missing persons program) administered by the Department of Justice (Justice), with a focus on determining whether it is meeting its statutory provisions and efficiently using its funds.

Finding #1: The missing persons program has recently reached full operation but will not complete existing work before the fee supporting the program expires.

After the missing persons program was created in January 2001, it faced several challenges in reaching full operation. These challenges included a hiring freeze for state agencies, the extensive training necessary for its staff, and low pay rates compared to other jobs requiring the same skills. Given these challenges, it seems reasonable that it took until July 2004 for the missing persons program to reach full operation. However, as of the end of February 2005, the program had received 799 requests for DNA analysis and 538 were awaiting analysis, which equates to 23 months of work. Program management has acknowledged that it will not be able to complete DNA analysis for all the requests before the fee supporting the missing persons program expires in January 2006.

Although some accumulation of work beyond what can immediately be processed is reasonable, the amount of work the missing persons program has accumulated suggests that in the short term the program does not have the capacity to process all of the requests it receives. In positioning itself for the long term, the program must ensure that its workload estimate is accurate.

Thus far, the program's estimate has been close to the number of requests it has received. However, the program's workload estimate is based on a calendar year 2000 report from Justice's Missing and Unidentified Persons System showing that coroners and local law enforcement agencies submitted 150 reports of unidentified human

☑ *The missing persons program is receiving the funding to which it is entitled and its costs are appropriate for a laboratory to incur.*

remains in that year. More recent information shows that the average number of deceased unidentified persons reported from 2001 through 2004 is 190 per year, 40 more than the program's estimate. In addition, the program's current estimate does not include the number of requests it will receive related to missing persons, including personal articles and DNA supplied by parents and relatives.

To ensure that it is based on the most current data and reflects future program demands, we recommended that the missing persons program review its workload estimate periodically.

Justice's Action: Corrective action taken.

The missing persons program reports that in December 2004 Justice implemented a system for tracking service requests using Justice Trax software. The missing persons program stated that it now has reliable workload statistics on a monthly and yearly basis.

Finding #2: It may be too soon to decide if the existing fee supporting the missing persons program should be made permanent.

Between January 1, 2001, and June 30, 2004, the missing persons program recorded revenues of $11 million and expenditures of $7 million in the Missing Persons DNA Data Base Fund (DNA fund). As of June 30, 2004, the program had a fund balance of nearly $4 million. Justice plans to use the fund balance in the DNA fund to continue operating the program should the $2 fee end on January 1, 2006, as the California Penal Code, Section 14251, currently requires. Using expenditure data from the first six months of fiscal year 2004–05 to estimate the program's expenditures for the full fiscal year, we estimate that the fund balance is sufficient for the program to operate for more than one year at current staffing and expenditure levels after the fee expires. However, Justice's plan assumes that certain changes will occur that would enable the missing persons program to continue operating using its fund balance, even though the authorization for the DNA fund and the $2 fee increase on death certificates both end on January 1, 2006. In addition to the missing persons program receiving a fiscal year 2005–06 appropriation, the Department of Finance would have to move the program's appropriation and fund balance to the General Fund. The missing persons program's operations would be halted by June 30, 2006, when its fiscal year 2005–06 appropriation expires, unless legislation continues the necessary fee or the Legislature appropriates any remaining fund balance in a successor fund for fiscal year 2006–07.

Assembly Bill 940 proposes making the $2 fee increase on death certificates permanent, to fund the missing persons program indefinitely. However, since the missing persons program has amassed a fund balance of $3.9 million and needs to update its workload estimate, coupled with the fact that the program only recently achieved full operation, it may be

too soon to decide if its funding should be made permanent. Therefore, we recommend that it may be more prudent for the Legislature to extend the $2 fee increase on death certificates for a defined period of time and then reassess the program's accomplishments and needs.

Legislative Action: Legislation enacted.

Assembly Bill 940 (Chapter 471, Statutes of 2005) was approved by the governor on October 4, 2005. This bill extends the fee supporting the program until January 1, 2010.

Finding #3: Several elements of the missing persons program are sound.

In creating the missing persons program, Justice has put into place several sound elements. Specifically, the program's staffing approach and training levels appear appropriate, it has successfully educated local law enforcement agencies about its program, and it has made reasonable efforts to obtain federal funding.

Missing persons program staff train for nearly two years before they are qualified to work with minimal direct supervision. Although the timeline is lengthy, the training process ensures that staff meet accreditation requirements and industry standards. In addition, its training process is comparable to that of laboratories doing similar work.

At its inception in 2001, the missing persons program did not have an existing pool of requests on which to begin analysis. By February 28, 2005, it had received 799 requests from local law enforcement agencies in 50 of California's 58 counties, such as Los Angeles, Orange, and San Diego. This suggests that the program has been effective in making its mission and services known to local law enforcement agencies. The program has used a combination of information bulletins, presentations at industry conferences, and a training video to communicate its mission and services.

Section 14251(a) of the California Penal Code states that the $2 fee increase on death certificates would remain in effect until January 1, 2006, or until federal funds became available, whichever is sooner. Thus, it appears that the Legislature contemplated a real possibility of federal funds to operate a missing persons DNA database. Although our review disclosed that some federal grants relate to DNA analysis, these funding opportunities are not specifically earmarked for DNA analysis of missing persons or unidentified human remains. Nevertheless, according to Justice, its process to identify appropriate federal grants includes sending representatives to the National Institute of Justice's annual meeting where future grant opportunities are discussed and using its budget office to research and coordinate efforts to identify federal funding.

Finding #4: The missing persons program could not provide sufficient documentation to support that it adheres to the priorities its advisory committee established.

The program's advisory committee, consisting of coroners, law enforcement officials, and other stakeholders, set up priorities for the program for processing DNA requests. However, we could not determine if the program is following the guidelines, because its list for documenting the priority it assigns to a request and the reasons why is incomplete. The list is designed to capture the following information: the request number; whether the request concerns a child; the cause of death, if known; whether the request concerns a specific missing person; and comments about the materials available for analysis, for example, a tooth, a femur, or hair. Despite containing

these categories, the list does not provide enough information to determine the request's priority, because it does not state the priority that was assigned and does not include all of the priority categories contained in the guidelines.

To ensure that the missing persons program is completing the most critical requests first and that its limited resources are focused on the highest-priority requests, it should amend its priority list to include all of the information used to determine the priority assigned to each request.

Justice's Action: Corrective action taken.

The missing persons program told us that it has included the priority code that is consistent with the guidelines developed by its advisory committee on its priority list for case assignments. The missing persons program stated that each case is maintained in the case assignments list along with its priority code so that the priority assigned to any particular case can be determined. Further, the missing persons program maintains the case assignment list on its computer network such that any laboratory management personnel can access the list and make staff assignments.

Finding #5: Some of the data the program's management information and timekeeping databases contain are not reliable.

The missing persons program uses a variety of databases, two of which contained data we believed would be relevant to the audit. One is a database the program uses to assist it in tracking and storing information related to requests for DNA analysis, and the other is one it uses for staff timekeeping. However, through our testing we determined that the data contained in the databases are inaccurate and not reliable for our audit purposes. The database the program uses to track requests contains some inaccurate dates and the timekeeping database lacks controls to ensure that approved time records are not changed, was missing a staff member's time, and included some time that was not recorded properly.

To make certain that it has effective tools to help manage and measure the program, missing persons program management should take the necessary steps to ensure that its management information and timekeeping databases contain accurate and reliable data.

Justice's Action: Corrective action taken.

The missing persons program reported that it has addressed the inaccuracies in its management information database. In addition, in its one-year response to our audit report, the missing persons program stated that its management information database was upgraded and new features of the database allow for better case and DNA analysis requests tracking. Also, the upgraded database allows the missing persons program to access more reports including workload statistics and unassigned, assigned, and complete DNA analysis requests. The missing persons program concurred with our evaluation of its timekeeping system and reported that Justice selected the Branch Time Reporting system to replace the current timekeeping system. The program noted that the new timekeeping system has many built-in security features including employee lock out following supervisory review. In addition, the new timekeeping system provides numerous tracking features.

Finding #6: Justice is receiving the revenues earmarked for the program and the program's expenditures appear reasonable.

According to Justice's accounting records, revenues for the program are $3 million per year. This amount substantially agrees with the fees due based on the number of death certificates issued for fiscal years 2001–02 through 2003–04.

We reviewed the program's expenditures for these same three fiscal years. Its facilities costs are the most significant expenditures, totaling $1.4 million for rent and $2 million for tenant improvements. However, these expenditures appear reasonable considering the program's space needs, the tenant improvements made, and the methodology Justice follows to determine the program's share of facilities costs. Finally, Justice's methodologies for apportioning personal services costs seem reasonable and the program's expenditures for other operating expense and equipment costs seem appropriate for a laboratory to incur.

MILITARY DEPARTMENT

It Has Had Problems With Inadequate Personnel Management and Improper Organizational Structure and Has Not Met Recruiting and Facility Maintenance Requirements

Audit Highlights . . .

Our review of the California Military Department (department) revealed that:

- ☑ *It has not effectively reviewed its state active duty positions, and as a result may be paying more for some positions than if they were converted to state civil service or federal position classifications.*
- ☑ *It has convened a panel to review the propriety of its 210 state active duty positions and estimates it will take three to five years to implement the panel's recommendations.*
- ☑ *It did not follow its regulations when it temporarily appointed many state active duty members to positions that do not appear to be temporary, failed to advertise some vacant positions as required, and inappropriately granted an indefinite appointment to one state active duty member after he reached the mandatory retirement age.*

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REPORT NUMBER 2005-136, JUNE 2006

California Military Department's response as of December 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Military Department's (department) resource management and recruitment and retention practices. Specifically, the audit committee asked that we review the department's operations and practices regarding strategic planning, the use of state and federal funds and personnel, the current condition of its armories, its management of state military personnel, recruitment and retention practices, and reporting of military personnel's attendance at training to maintain their military skills.

The department is responsible for the command, leadership, and management of the California National Guard (Guard), including its army and air force components, and related programs, such as the State Military Reserve and the Guard's youth programs. The Guard provides military service to California and the nation and serves a threefold mission: as a reserve component of the U.S. Army and Air Force, the Guard provides mission-ready forces to the federal government, as directed by the president; it supports the public safety efforts of civil authorities during emergencies, as directed by the governor; and it provides military support to communities, as approved by the proper authorities. The state adjutant general, who is appointed by the governor and confirmed by the state Senate, serves as director of the department and commander of the Guard.

Finding #1: The department has not effectively reviewed its state active duty positions, as required by its regulations, to determine whether those positions could be filled with state civil service employees.

The Military and Veterans Code grants the governor the authority to activate or appoint part-time Guard members to full-time duty, known as state active duty. The department's regulations require that the department review its state active duty positions periodically to determine whether they would be more appropriately classified as state civil service positions or federally funded positions. These state active duty positions are staffed

- ☑ *It is deficient in its management of federal employees by using them in positions and for duties that are not federally authorized.*
- ☑ *State active duty members who become whistleblowers do not have access to an independent authority to resolve complaints of alleged retaliation.*
- ☑ *Although the department's strategic planning process was interrupted by the events following September 11, 2001, and ultimately abandoned by the former adjutant general, the department has recently revived the process.*
- ☑ *In establishing new headquarters' divisions and an intelligence unit, the former adjutant general failed to obtain state approval.*
- ☑ *The department used federal troop commands and counterdrug program funds for unauthorized purposes when it formed a field command for operations to support civil authorities and established additional weapons of mass destruction response teams.*
- ☑ *The department was unable to demonstrate that it ensured all misused counterdrug funds were reimbursed from other federal sources.*
- ☑ *In recent years, the Army National Guard and the Air Guard did not meet their respective goals for force strength.*

with military personnel who receive federal military pay and allowances that in some cases greatly exceed the costs to employ state civil service employees. For example, a colonel responsible for records management, printing, mail services, and supplies management receives an annual salary of about $125,500, while a civil service counterpart in another state department with similar responsibilities receives an annual salary of $62,300. The department's adjutant general has convened the State Active Duty Reform Panel (panel) to review the department's use of state active duty members. The panel's tasks include reviewing the state active duty positions to determine if the responsibilities of those positions could be performed by other state or federal position classifications available to the department. The panel is also addressing other past personnel practices of the department, such as creating more state active duty positions than the budget authorized. The department estimates it will take three to five years to implement any changes the panel recommends.

To reform its use of state active duty personnel and comply with its senior leadership's wishes for how they should be used, we recommended the department ensure that the panel completes the tasks assigned to it by the adjutant general and follows through with the panel's recommendations.

Department's Action: Partial corrective action taken.

The department reports that it has reviewed all of the 210 baseline state active duty positions and additional positions, such as temporary positions and positions already under transition to nonstate active duty status. The department states that the actions it has completed regarding the positions it reviewed include developing or modifying position descriptions, reclassifying positions when appropriate, considering downgrading or eliminating positions, and advertising those positions identified for transition from state active duty to either state civil service or federal technician.

The department further reports that although it has not completed its plan to convert positions targeted for transition from state active duty to other status, it has begun converting those positions. For example, the department reports that it has converted every targeted position that has become vacant through normal personnel actions. As of December 2006 the department has converted 10 of 60 targeted positions and the remaining positions will be converted when they become vacant through reassignment, retirement, or resignation. The department estimates it will take an additional 24-36 months to convert the remaining targeted state active duty positions.

- ☑ *The department does not maintain adequate procedures to demonstrate it accurately reports training attendance or monitors and addresses Guard members with excessive absences.*
- ☑ *The State Military Reserve has not met its force strength goals in recent years; and the department has not identified the role for the State Military Reserve, allowing it to identify its force strength needs.*
- ☑ *Ninety-five of the department's 109 armories are in need of repair or improvement, contributing to a $32 million backlog.*
- ☑ *The department's allocations of state and federal funding, including a relatively small amount of money from the Armory Fund, have not been adequate to maintain the armories.*

Finding #2: The department engaged in questionable practices related to its state active duty workforce.

The department temporarily appointed numerous state active duty members to positions that do not appear to be temporary in nature. In many cases, the department repeatedly extended temporary appointments for set periods—usually one year—that in effect converted them into appointments of indefinite duration. The department's regulations define temporary appointments as those with specified end dates. Further, the department has not always followed its requirement of announcing a vacant state active duty position before filling it. Announcing vacant positions allows qualified individuals to compete for the positions.

Also, the department did not follow state law and its regulations when, in September 2001, it granted an indefinite appointment to a state active duty employee who had reached the mandatory retirement age. State law sets the mandatory retirement age for state active duty members at 60. For an employee to remain in a state active duty position beyond age 60, he or she must obtain approval from the adjutant general and then can hold only a temporary position. The adjutant general has directed the panel to review the department's hiring policies and practices for the state active duty program and suggest necessary changes to the department's regulations to conform to the Military and Veterans Code.

We recommended the department review its hiring policy and practices for state active duty members, as directed by the adjutant general, and make the necessary changes in its policy and regulations to provide adequate guidance to its commanders and directors.

Department's Action: Pending.

The department reports that although it originally planned to implement this recommendation by October 2006, it has since concluded that updating the department's policies and regulations was not a task suitable for the panel and has decided to form a separate team to accomplish the task. The adjutant general will appoint the team in January 2007 and expects the team's task to be completed during the first quarter of calendar year 2007.

Finding #3: The department's overall management of its federal employees is deficient.

The National Guard Bureau pays for the federal full-time military members and civilian employees the department uses to support the department's large part-time force. Yet the department does not always use those federal personnel in the positions and for the duties authorized by the National Guard Bureau. For example, the department's analysis identified at least 25 full-time active guard reserve members in the joint force

headquarters working in unauthorized positions as of January 26, 2006. As of March 1, 2006, the State was authorized to have 48 active guard reserve personnel in its joint force headquarters, yet 76 were actually assigned and working there, leaving other Guard units short staffed.

According to the chief of staff of the Joint Staff and the chief of staff of the Army Guard, numerous factors explain why the department has exercised poor control over its full-time staff. These factors include undocumented movement of personnel over a long period under the command of many past adjutants general, the department's use of outdated authorizing documents, and confusion over whether the Joint Staff or the Army Guard is responsible for issuing orders for full-time personnel.

We recommended the department develop and implement procedures to ensure that it complies with authorizations for federal full-time military personnel to support its part-time Guard forces. Those procedures should include designating the responsibility for issuing orders for full-time personnel to a single entity.

Department's Action: Partial corrective action taken.

The department states that it has always complied with overall authorizations for full-time manning and points out it believes that the issue was to what extent the department had authority to move allocations between units. The department points out that the adjutant general has the authority to assign full-time active guard reserve members to any unit or organization necessary to accomplish federal and state missions. However, the department also points out that this authority does not eliminate its requirement to consider the allocation rules used by the National Guard Bureau to provide these resources to the State, and to the extent possible, assign these resources in accordance with unit by unit allocations.

Nonetheless, the department states it has reviewed its allocations of authorized federal full-time personnel and mission requirements with the intent to more closely align staff assignments with position authorizations. As a result, the department reports it has reassigned 35 percent of the full-time active guard reserve members that were previously assigned to the joint forces headquarters. Further, the department states that ongoing management of its mission requirements and future resource allocations will, to the maximum extent practicable, minimize the future disparities between resource allocations and assignments.

Finally, the department reports that it has assigned the responsibilities for issuing orders for full-time members solely to the active guard and reserve branch within the joint forces headquarters.

Finding #4: We could not confirm that the department disseminates information on benefits to deploying Guard members.

Although regulations and department procedures require the department to inform all members who are called to active duty and deployed for service of the benefits available to them as active members of the Guard, the department could not provide evidence that it had done so. Nevertheless, nothing came to our attention that led us to believe these members did not receive benefits briefings. Among the benefits included are medical, dental, life, and unemployment insurance and reemployment rights. The department provided descriptions and handbooks containing evidence that it has processes that offer multiple opportunities to inform deploying Guard members and their families of the benefits available to them during members' active duty status. However, the department's checklists and others records are not sufficient to allow us to confirm who has received these benefits briefings, and the records are not kept for all deploying Guard members. Because the department does not retain written evidence of who has received a briefing, we could not confirm that Guard members are aware of their benefits.

Because the department has a responsibility under federal regulations to inform deploying members of the benefits available to them while on active duty, we recommended the department consider implementing a procedure for both the Army Guard and the Air Guard to demonstrate that it complies with that requirement.

Department's Action: Corrective action taken.

The department reports that subsequent to the release of our audit report, it conducted a review of the processes used during pre-mobilization activities and completed discussions with the federal oversight authorities responsible for oversight and approval of the department's pre-mobilization activities and actions. Although the department concluded it complies with federal requirements for the pre-mobilization processing, it acknowledged that additional opportunities exist to document its compliance. The department states its review and actions will improve its ability to document the actions taken during pre-mobilization activities.

Finding #5: State active duty members do not have access to an independent process to resolve complaints of retaliation against whistleblowers.

In contrast to legal protections for federal employees who act as whistleblowers, state active duty members who become whistleblowers do not have access to an independent authority to resolve complaints regarding retaliation. Rather, department regulations require that state active duty personnel attempt to resolve their complaints through the lowest level of supervision or state active duty chain of command before filing an official complaint with the department's State Personnel Office. As a result, a state active duty member lodging a complaint of retaliation is forced to first lodge a grievance with the same commander who allegedly engaged in retaliation.

To ensure that its state active duty personnel can report any alleged violations of statutes, regulations, or rules without fear of retaliation, we recommended the department establish a process independent of the chain of command to protect those state active duty personnel who wish to file complaints alleging retaliation by a superior.

Department's Action: Pending.

The adjutant general supports providing state active duty personnel the ability to register legitimate complaints without fear of retribution by superiors. In addition, the department states that because it does not have the authority to establish an independent process, it is prepared to work closely with state authorities to create an independent state inspector general.

Finding #6: The department does not adequately maintain files to demonstrate that it complies with regulations concerning allowable activities.

Reviews and recommendations regarding legal or ethical conduct are supplied by the Staff Judge Advocate's Office using Standards of Ethical Conduct (ethics standards) issued by the Department of Defense. Because the Staff Judge Advocate's Office does not keep logs of the requests for outside activities it reviews or records of the recommendations it provides to leadership, it cannot demonstrate, nor can we confirm, that the department consistently follows the guidance contained in the ethics standards.

We recommended that in order to demonstrate the department complies with the ethics standards, the Staff Judge Advocate's Office implement a system to log the activities it reviews and to maintain files of the opinions it provides to department leadership on questions of compliance with those ethics standards.

Department's Action: Corrective action taken.

The department reports that the Staff Judge Advocate's Office has established a procedure to maintain duplicate files of ethics opinions: one file of opinions by the individuals' name or the name of the operation, and one in a central file.

Finding #7: The department's lack of an adequate strategic planning process contributed to its questionable reorganizations.

The Guard's strategic planning process was interrupted after the events of 9/11 and was subsequently abandoned altogether by the former adjutant general. Without a current strategic plan and a formal strategic planning process for identifying and analyzing threats and opportunities, the department cannot measure how well it is accomplishing its federal and state missions. In the absence of a properly prepared strategic plan, the former adjutant general chose to place a greater emphasis on providing military support to civil authorities. In doing so, he sponsored the creation of unauthorized entities, such as the Civil Support Division in its headquarters and an expanded intelligence unit within it, and a field brigade, known as the MACA Brigade, to command military support to civil authorities. However, because the department at that time did not have a strategic planning process that would have justified the need for those entities, we cannot conclude that the former adjutant general's change in emphasis was warranted. Although the department recently took steps to again implement a strategic planning process, had it adhered to the principles of strategic planning in the past, many of the problems associated with the former adjutant general's organizational changes might have been avoided.

In its efforts to implement the former adjutant general's perception of the organizational mission, the department violated state and federal laws and regulations. First, the department established the new organizational entities without obtaining state and federal approval. For example, the department did not obtain the required approval from the state Department of Finance to establish the new entities within its headquarters. Second, the department used federal troop command units for purposes not authorized by the federal National Guard Bureau when it combined the resources assigned to the units and formed a field command headquarters to support civil authorities.

We recommended that in order to avoid public concern and promote transparency and to comply with state and federal laws, regulations, and administrative policies, the department continue its efforts to reimplement a strategic planning process. This process should include the in-depth analyses of the threats and opportunities facing the department, including changes in the environment and leadership. In addition, the department should obtain appropriate approvals from the state Department of Finance and the federal National Guard Bureau before making organizational changes in the future.

Department's Action: Partial corrective action taken.

The department reports that it has continued its reimplementation of a strategic planning process that involves input from staff—a process it says continues to mature. The department reports it continues to track organizational and operational goals to ensure allocation of resources and efforts on priority issues related to the strategic plan. Management's current focus requires that the status of every goal be reported to management on a monthly basis. In addition, the department states that it continues to refine and update its strategic plan, and anticipates initiating its first annual update of its strategic plan with an executive off-site meeting scheduled for April 2007.

Further, the department reports that it has confirmed with the National Guard Bureau that its current efforts to complete reorganizations are in agreement with the policies, procedures, and guidelines provided by the National Guard Bureau. The department also states that it has coordinated current organizational changes with the Department of Finance and has received approval for the current organizational configuration and is conducting discussions with the Department of Finance to ensure the department gains approval prior to any future organizational changes.

Finding #8: The department inappropriately used federal counterdrug program funds to command the MACA Brigade and establish its terrorist response capabilities.

The department directed the use of resources from the federal counterdrug program to operate the field command headquarters and to establish weapons of mass destruction response teams beyond what was federally authorized and funded. We believe this misuse of resources violated federal counterdrug laws and regulations. In addition, the department could not prove that it ensured that all the misused funds were reimbursed from other federal sources. Although we were able to confirm that most of the $783,000 in misused counterdrug program funds were reimbursed, the U.S. Property and Fiscal Officer (U.S. fiscal officer)—the federal agent of the National Guard Bureau that handles the federal property and federal funds for the California's Army Guard and Air Guard—was unable to provide evidence that action was taken to reimburse more than $85,500 for Army Guard and Air Guard personnel pay and allowances and equipment costs.

To ensure that all federal counterdrug program funds used for non-counterdrug activities are properly reimbursed, the department should work with the U.S. fiscal officer to identify all the non-counterdrug costs that have yet to be reimbursed and to ensure that the transfer of costs from the appropriate accounts occurs. In the future, the department should not use counterdrug program funds for non-counterdrug activities.

Department's Action: Partial corrective action taken.

The department reports that the U.S. fiscal officer has determined that no further reimbursement would be appropriate for $66,000 of the $85,500 amount we identified in our report. According to the department, the U.S. fiscal officer based his decision on his opinion that the amount was either offset by previous reimbursements or cannot be validated as costs charged to the counterdrug program. Reimbursement of the remaining amount will require a transaction at the National Guard Bureau level and the U.S. fiscal officer is working with Air National Guard Financial Management to enact the reimbursement to the counterdrug program.

Further, the department states its leadership, in conjunction with the U.S. fiscal officer, has reviewed the restrictions for the use of counterdrug program funds and will not use these funds for noncounterdrug program purposes without prior approval from the National Guard Bureau. Also, the department stated it is in the process of establishing an internal control program that will have the capability to review and audit financial transactions and cost allocations to ensure they conform with federal and state guidelines.

Finding #9: The department has not met recent force strength goals.

Although California's Army Guard met its goal for federal fiscal year 2003, its performance in meeting its goals for federal fiscal years 2004 and 2005 declined. According to the Army Guard, maintaining prescribed force levels has become increasingly difficult because of several factors, including a perceived lack of state incentives. However, if the department does not meet its force strength targets, the

National Guard Bureau may redistribute federal resources to states that do meet their targets—resources the department needs to achieve its state mission of providing military assistance to California's civil authorities in times of insurgence or catastrophic events.

Like the Army Guard, the Air Guard has not met its force strength targets, and its performance in meeting those targets has slipped over the past three years. Although the Air Guard achieved 93 percent of its force strength goal in federal fiscal year 2005, it ranked 38th among the 54 jurisdictions (states, territories, and the District of Columbia). The Air Guard attributes its diminished ability to meet force strength goals to the fact that goals are consciously set high to achieve optimum force strength, the ongoing war, and a smaller pool of personnel with prior service to recruit from.

We recommended that the department identify and pursue the steps necessary to meet the force strength goals set by the National Guard Bureau, including but not limited to identifying the most effective manner to use the additional recruiting resources provided by the National Guard Bureau and continuing to pursue, through the State's legislative process, incentives it believes will encourage citizens to join the Guard.

Department's Action: Partial corrective action taken.

The department states that its actions have resulted in the Guard meeting or exceeding its national targets for both new recruits and overall end strength for the federal fiscal year ending September 30, 2006. The department expects to sustain its success in maintaining overall force strength through the newly released recruiting initiative called the Guard Recruiter Assistance Program. Under this program, Army and Air guardsmen are encouraged to recruit for their respective units through a $2,000 cash payment for each new member they recruit.

Further, the department points out that the federal government provides incentives to help maintain force strength, such as $20,000 bonuses for enlistment and re-enlistment and $20,000 for student loan repayments and education assistance. However, the department states that additional incentives from the State, such as tuition assistance, health care, state income tax exemption, life insurance tax credit for deployed soldiers, and a cash referral incentive, could considerably assist it in meeting recruiting and retention goals.

Finding #10: The department needs to improve its procedures for monitoring training attendance.

Because we found discrepancies in the attendance data reported by the Army Guard units and not all of the units we contacted provided the information we requested, we could not verify the accuracy of the reported attendance for 22 of the 25 Army Guard units we reviewed. Further, Air Guard headquarters does not monitor training attendance; rather, it relies on the units to accurately report attendance.

In addition, neither the Army Guard nor the Air Guard fully responded to our requests for evidence of actions taken for members with excessive unexcused absences from training. By retaining on its rosters members who do not meet their training obligations, the Guard could report an inflated number of members adequately trained and prepared to meet its missions. Using a January 2006 report provided by the National Guard Bureau, we identified 250 Army Guard members who had not attended training for at least three months. According to the chief of staff of the Army Guard, it strives to meet the National Guard Bureau's standard of keeping the proportion of members on this report below 2 percent of the total roster, which it met as of January 2006. According to the personnel officer of the Air Guard headquarters, prolonged or numerous absences are a cause of concern. However, ensuring the capability of a unit to meet its mission, including preparedness through training, and accomplishment

of its mission are the responsibility of the unit commander. Commanders can use their discretion in evaluating an absent member's potential for useful service and can attempt to bring him or her back into compliance with training requirements.

We recommended that the department enhance or develop and implement procedures to monitor training attendance by its Guard members to ensure that it can verify the accuracy of reported training attendance. It should also ensure that it does not retain on its rosters members who qualify as unsatisfactory participants because they are not meeting their training obligations. Finally, the Air Guard should consider some level of oversight of the handling of members with excessive unexcused absences.

Department's Action: Corrective action taken.

The department states that both the Army and Air Guard have instituted additional measures to retain documentation that can serve to verify the accuracy of attendance reports. At headquarters, the Air Guard recently instituted a requirement that each wing provide a monthly report of members with unsatisfactory participation in training activities. These reports demonstrate the action taken on individuals with unexcused absences. The department reports that during a recent meeting with wing commanders, the commander of the Air Guard reiterated the importance of taking timely action to either return wayward members to duty or impose appropriate disciplinary measures, ranging from stern notification memorandums to demotion or involuntary separation for cause.

In addition, the department states that the Army Guard headquarters will continue to monitor local unit attendance reports and will institute corrective action for units that fail to meet the national federal standard for accurately reporting attendance.

Finding #11: The department's State Military Reserve has not met its force strength goals.

The State Military Reserve—a corps of volunteers, most with military experience, who support the Guard—also has not met its force strength goals in recent years. For calendar years 2003 through 2005, the State Military Reserve achieved only 56 percent to 65 percent of its goals. However, the department had not provided adequate guidance to the State Military Reserve regarding the department's mission for the State Military Reserve to allow it to determine its needed force strength. The State Military Reserve performs various services for the Guard, such as training, helping with mobilization, and assisting civilian authorities. Although the department appears to value the State Military Reserve's help in fulfilling the Guard's mission, as of April 2006 the department had not yet formally identified the specific role and responsibilities of the State Military Reserve within its draft strategic plan. The department's draft strategic plan calls for finalizing the plans for how the State Military Reserve can best support the needs of the Guard and the department by the end of 2006.

We recommended the department include the State Military Reserve in its current strategic planning process and ensure that it defines the State Military Reserve's role and responsibilities so as to maximize the support it provides to the Guard. Once its role and responsibilities are identified, the State Military Reserve should target its recruiting goals and efforts accordingly.

Department's Action: Partial corrective action taken.

The department reports that the State Military Reserve was included as a full partner in the department's strategic planning process, during which it collaboratively identified its vision, mission, core competencies, and priority issues. In addition, the State Military Reserve has developed action plans to implement its priorities and the department is updating the manning

document for the State Military Reserve, which will further integrate it into the overall organization of the department and facilitate a focused recruiting program to align potential recruits with vacancies. The department anticipates completing the updated manning roster and recruiting action plans before April 1, 2007.

Finding #12: The department's armories are in poor condition and the department has identified $32 million in unfunded maintenance needs.

Of the department's 109 armories, 95 (about 87 percent) are in need of repair and improvement. As of March 2006, the department had identified about $32 million in backlogged repairs, maintenance, and improvements it could not fund. Funding to maintain the armories is provided primarily through appropriations from the State's General Fund and matching funds through cooperative agreements with the federal government. Some additional funding comes from the Armory Fund and the Armory Discretionary Improvement Account through the sale or lease of unneeded armories and the receipts from renting armories when not in use, but those amounts are minor compared with the armories' overall needs. Moreover, as a result of a ballot initiative passed by the voters in 2004, most Armory Fund revenue will be used to reduce the outstanding Economic Recovery Bond debt and will no longer be available to the department.

According to the department's facilities director, the solution to the problems of the department's aging armories is a balanced program of replacement, modernization, and maintenance and repair. All of these activities involve some degree of federal funding that requires a corresponding expenditure of state funds. The facilities director stated that the maintenance and repair component of the program has been underfunded. He stated that the department is working with the Legislature and the Department of Finance to establish a baseline budget for maintenance and repair of the armories. The baseline would assist the department in justifying its need for increased funds to maintain, repair, and modernize its armories.

To help ensure that the department works toward improved maintenance of its armories, we recommended that the department pursue the balanced program for replacement, modernization, and maintenance and repair advocated by its facilities director. In addition, the department should continue to work with the Department of Finance and the Legislature to establish a baseline budget for the maintenance and repair of its armories.

Department's Action: Pending.

The department reports that it completed construction of two new armories in 2006 and two additional new armories are planned for completion in 2007. In addition, the department states it has completed two of the four armory modernization projects it had planned for 2006. A third modernization project is currently under construction and the fourth is in the final design stage.

The department states that it continues to work with the Department of Finance and the Legislature to establish a budget for the maintenance and repairs of its armories with a goal to eliminate the continued growth in backlogged maintenance and repair, which currently totals over $36 million.

CALIFORNIA MILITARY DEPARTMENT

Investigations of Improper Activities by State Employees, January 2005 Through June 2005

INVESTIGATION I2004-0710 (REPORT I2005-2), SEPTEMBER 2005

California Military Department's response as of November 2006

Investigative Highlight . . .

A supervisor with the California Military Department embezzled at least $132,523 in state funds over an eight-year period.

We investigated and substantiated an allegation that a supervisor with the California Military Department (Military Department) embezzled public funds.

Finding: The supervisor fraudulently appropriated state funds under his control and failed to stop payments to a retired service member who had died and then stole the deceased individual's retirement checks.

Over an eight-year period, the supervisor embezzled at least $132,523 as follows: $111,507 from the Military Department's system for processing emergency state active duty payroll; $12,393 from the department's revolving fund; and $8,623 from the retired state active duty system used to process retirement payments (retirement payments). The supervisor fraudulently initiated at least 60 checks in the names of his family members totaling a gross amount of $123,900. At least 43 of these payments, totaling $87,483, were deposited into his bank accounts. In addition, the supervisor stole at least four retirement payments totaling $8,623 that were payable to a former service member who had died.

Military Department's Action: Corrective action taken.

The Military Department asked the California Highway Patrol (Highway Patrol) to investigate the criminal aspects of this case. The Highway Patrol interviewed the supervisor who admitted to the embezzlement and thefts. After completing its investigation, the Highway Patrol referred the case to the Sacramento County District Attorney for prosecution. According to court records, the supervisor was charged with and convicted on two felony counts, including grand theft and embezzlement, and was ordered by the Sacramento Superior Court (Court) to pay court costs and fees of $410 and to make restitution to the State in the amount of $132,523, the amount we identified that he embezzled. Finally, the Court sentenced the supervisor to 16 months in state prison.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

It Relied Heavily on Blue Shield of California's Exclusive Provider Network Analysis, an Analysis That Is Reasonable in Approach but Includes Some Questionable Elements and Possibly Overstates Estimated Savings

Audit Highlights . . .

Our review of the decision by the California Public Employees' Retirement System (CalPERS) board of administration (board) in May 2004 to approve an exclusive provider network for CalPERS members in the Blue Shield of California (Blue Shield) health maintenance organization (HMO) found the following:

- ☑ ***Our consultants found that many components of Blue Shield's analysis appear reasonable but some questionable elements exist such as using claim data from non-CalPERS sources.***
- ☑ ***Blue Shield's original savings estimate did not incorporate a health system's financial terms that were expected to produce substantial savings in 2005 only if the board did not adopt the exclusive provider network.***

continued on next page . . .

REPORT NUMBER 2004-123, MARCH 2005

California Public Employees' Retirement System's response as of March 2006

The Joint Legislative Audit Committee requested the Bureau of State Audits to examine the California Public Employees' Retirement System (CalPERS) decision to discontinue contracting with certain hospitals through the Blue Shield of California (Blue Shield) health maintenance organization (HMO) provider network. Our consultants found that many components of Blue Shield's analysis appear reasonable but some questionable elements exist such as using claim data from non-CalPERS sources. In addition, Blue Shield's original savings estimate did not incorporate a health system's financial terms that were expected to produce substantial savings in 2005 only if the board did not adopt the exclusive provider network. Also, Blue Shield's estimate of $31.4 million in savings does not take into consideration the impact of members leaving its HMO provider network and joining other health care plans. Further, Blue Shield did not adequately address a recommendation to investigate differences in emergency room assumptions for one health system. According to our consultant, Blue Shield's hospital savings estimate of $20.6 million could drop to only $8.9 million if the model-review actuary's assumptions were used. Moreover, the CalPERS board, health benefits committee (committee), and health benefits branch staff relied primarily on Blue Shield's summary of its analyses and its presentations in deciding to approve the exclusive provider network. Although a model-review actuary was hired to, among other things, review Blue Shield's cost savings projections, he was unable to express an opinion on the savings estimate of $36.3 million related to the 38 hospitals; thus, his report could not provide a credible basis for the CalPERS board to evaluate the savings estimate. Finally, in one instance, our consultant found that Blue Shield deviated from its original criteria for excluding hospitals from the network.

- ☑ *Blue Shield's estimate of $31.4 million in savings does not take into consideration the impact of members leaving its HMO provider network and joining other health-care plans.*
- ☑ *Blue Shield did not adequately address a recommendation to investigate differences in emergency room assumptions for one health system. According to our consultant, Blue Shield's hospital savings estimate of $20.6 million could drop to only $8.9 million if the model-review actuary's assumptions were used.*
- ☑ *The CalPERS board, health benefits committee, and health benefits branch staff relied primarily on Blue Shield's summary of its analyses and its presentations in deciding to approve the exclusive provider network.*
- ☑ *Although a model-review actuary was hired to, among other things, review Blue Shield's cost savings projections, he was unable to express an opinion on the savings estimate of $36.3 million related to the 38 hospitals; thus, his report could not provide a credible basis for the CalPERS board to evaluate the savings estimate.*
- ☑ *In one instance, our consultant found that Blue Shield deviated from its original criteria for excluding hospitals from the network.*

Finding #1: CalPERS relied primarily on Blue Shield's summary of its analyses and presentations in making the decision to exclude hospitals.

A provision of the contract between CalPERS and Blue Shield specifies that Blue Shield cannot disclose information to CalPERS that would cause it to breach the terms of any contract to which it is a party. According to Blue Shield, the terms of the contract between it and providers in its network specifically prohibit the disclosure of certain information, including rates of payment. Consequently, CalPERS health benefits branch staff did not have access to hospital rates, nor could they review Blue Shield's cost model. As a result, CalPERS was unable to verify the accuracy of Blue Shield's cost comparison data.

We recommended that the Legislature consider enacting legislation that would allow CalPERS, during its contract negotiation process, to obtain relevant documentation supporting any analyses it will use to make decisions that materially affect the members of the health benefits program established by the Public Employees' Medical and Hospital Care Act.

Legislative Action: Unknown.

Finding #2: CalPERS did not fully consider all of the findings and recommendations made by the actuary hired to perform a third-party review prior to approving the exclusive provider network.

CalPERS health benefits branch staff directed Blue Shield to hire an independent actuary (model-review actuary) to conduct a third-party review to resolve differences between Blue Shield's and a health system's analyses. Blue Shield's contract with the model-review actuary also required him to review the cost savings projections for the exclusive provider network. The model-review actuary issued his final report to Blue Shield and CalPERS in April 2004, which contained numerous findings and recommendations. Although the board and committee discussed Blue Shield's savings estimate in meetings held before the board voted to approve the exclusive provider network in May 2004, our review of the transcripts found that they did not discuss all of the model-review actuary's findings and recommendations or the impact of the findings and recommendations on the CalPERS board's decision. Without fully addressing all of the concerns raised by the model-review actuary, CalPERS had no assurance from an independent source that Blue Shield's savings estimate, as well as other aspects of its model, were accurate.

We recommended that, to ensure its decisions are in the best interests of CalPERS members, CalPERS should require its health benefits branch staff to evaluate fully the findings and recommendations of third-party reviews and present their results to the board and committee.

CalPERS' Action: Corrective action taken.

CalPERS stated that, effective September 1, 2005, it implemented procedures to formalize its procedures for coordinating, analyzing, and reporting on third-party reviews. These procedures require CalPERS' management to appoint a third-party review coordinator to oversee reviews. The procedures also require the coordinator to examine the scope of work and contract for third-party reviews; act as the liaison between CalPERS' management and reviewing entities; monitor the reviews; evaluate draft third-party review reports; and analyze and summarize final third-party review reports, including any problems or limitations in the work. Further, the procedures require CalPERS' management to convey the results of third-party reviews and the coordinator's summaries to the CalPERS board or one of its committees.

STATE ATHLETIC COMMISSION

The Current Boxers' Pension Plan Benefits Only a Few and Is Poorly Administered

Audit Highlights . . .

Our review of the State Athletic Commission (commission) and the boxers' pension plan revealed that:

- ☑ *Under the current plan only four boxers per year are vesting.*
- ☑ *The current plan will likely give an average 55-year-old vested boxer a pension benefit of $170 per month, while the original plan would have paid $98 per month.*
- ☑ *During the four-year period from 2001 through 2004, payments for pension plan administration costs were six times greater than the amount of benefits paid to boxers.*
- ☑ *Since the inception of the current plan, the commission met the minimum funding requirement in only one out of nine years.*
- ☑ *Poor administration of the pension plan resulted in untimely recording of pension contributions, inaccurate reporting of boxers' eligibility status, and incorrect account balances.*

REPORT NUMBER 2004-134, JULY 2005

State Athletic Commission's response as of August 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the State Athletic commission's (commission) pension plan operations. Specifically, the audit committee was interested in the condition of the current plan, the best course of action to ensure its long-term viability, how much is being spent on administrative expenses, and whether the statutory requirements for pension contributions and benefit distributions are being met. In doing so, we noted the following findings:

Finding #1: Although potentially more generous than the original plan, the current pension plan benefits even fewer boxers.

Combining both the defined benefit plan (original plan) and the defined contribution plan (current plan), only 14 percent of licensed boxers have vested as of December 31, 2003, and account balances for most vested boxers are small. Under the current plan, which began in May 1996, only four boxers per year are vesting compared to 37 boxers per year vesting under the original plan. If the current vesting trend continues, the remaining number of vested boxers will plateau at below 80 in 2036. Although vested boxers currently approaching retirement age are likely to receive more benefits than the original plan guaranteed, pension amounts will still be minimal. The current plan will likely give an average 55-year-old vested boxer a pension benefit of $170 per month, while the original plan would have paid $98 per month. From 2001 to 2004, benefit payments to boxers totaled $36,000 while the payments to administer the plan were six times higher.

We recommended that the Legislature may want to reconsider the need for a pension plan for retired professional boxers since so few boxers annually meet the current criteria of a professional boxer. If the Legislature decides to continue the boxers' pension plan, we recommended that the commission could consider eliminating the break in service requirement and/or reducing from four to three the number of calendar years that a boxer must fight, if it believes the current vesting criteria is excluding

professional boxers for which the pension plan was intended. Further, the commission should mail an annual pension statement to all vested boxers to increase the likelihood that vested boxers are locatable for benefit distribution after they turn age 55.

Commission's Action: Partial corrective action taken.

In order to ensure that the pension plan provides benefits to the professional boxers that were intended, by September 15, 2006, the executive officer expected to complete his review of alternative vesting criteria that would give consideration to a boxer's age (i.e., actual age, number of years boxing, total actual number of rounds fought, number of times knocked out, number of times suspended, etc.). To increase the likelihood that vested boxers are locatable after they turn age 55, the commission plans to send each boxer an annual statement regardless of activity status. For any annual statements that are returned as undeliverable, it will resend the statement to any secondary address that may be available.

Finding #2: The commission has many problems with its day-to-day administration of the boxers' pension plan.

The boxers' account balances of $3.39 million could have been higher had the commission fully exercised its legal authority to maximize contributions to the current plan. Although the commission increased the ticket assessment to 88 cents per ticket in July 1999, it only met the target in one of nine years and has undercollected by a total of $300,000. Additionally, the commission performs its administrative duties related to the boxers' pension fund slowly and inaccurately. We found problems with untimely depositing of incoming checks to the Department of Consumer Affairs' (Consumer Affairs) bank account, remittances of pension contributions to the boxers' pension fund, and production of accurate eligible round and purse information; missing boxing contest documents needed to support contribution allocations to boxers; and various errors in determining boxers' eligibility and allocation of amounts to boxers' accounts. As a result, the recording of pension contributions were delayed, boxers' eligibility status were inaccurate and their respective account balances were incorrect. Moreover, the commission needs to periodically review boxers' eligibility status and account balances to ensure that the pension plan administrator correctly determines boxers' eligibility and account balances.

To maximize pension fund assets, we recommended that the commission should raise the ticket assessment to meet targeted pension contributions as required by law and promptly remit pension contributions from Consumer Affairs' bank account to the boxers' pension fund. To ensure receipts are deposited in a timely manner, we recommended the commission should implement the corrective action proposed by the acting executive officer to Consumer Affairs related to ensuring timely deposit of checks. Additionally, the commission should require promoters to remit pension fund contributions on checks separate from other boxing show fees so that deposits of checks and subsequent remittances to the boxers' pension fund are not delayed. To ensure boxers' information concerning eligibility status and pension account balances are accurate, the commission should retain all official documents from each boxing contest. Further, the commission should immediately work with the pension plan administrator to correct errors related to boxers' eligibility status and account balances. Lastly, the commission should periodically review a sample of newly vested and pending boxers, and verify their eligibility status and pension account balances.

Commission's Action: Partial corrective action taken.

The commission is considering various alternatives to meet the funding target, including negotiating with tribal governments to collect contributions from fights on tribal lands, redirecting some broadcast revenues to the pension fund, and raising the per ticket assessment to $1.25. The commission has taken steps to ensure that previously collected pension contributions have been deposited in the pension fund and that future collections are deposited in the pension fund in a timely manner. One of these steps is directing promoters to remit checks for pension contributions separate from checks related to show fees. In order to ensure eligibility information is being retained, the commission has created and is using a checklist of all documents that are required to be retained in its files. The commission is in the process of completing its research related to correcting errors in boxers' eligibility status and account balances and anticipated it would finish this review by December 12, 2006.

STATE BAR OF CALIFORNIA

It Should Continue Strengthening Its Monitoring of Disciplinary Case Processing and Assess the Financial Benefits of Its New Collection Enforcement Authority

REPORT NUMBER 2005-030, APRIL 2005

State Bar of California's response as of April 2006

Audit Highlights . . .

Our review revealed that the State Bar of California:

- ☑ *Continued to monitor its backlog of disciplinary cases and reported 402 cases in the backlog at the end of 2004.*
- ☑ *Continued to conduct semiannual reviews of disciplinary case files; however, it noted deficiencies similar to those found in its 2002 reviews.*
- ☑ *Developed a checklist for case files and adopted a policy to spot check active cases as we recommended, but the checklist is not comprehensive and staff have not consistently performed the spot checks.*
- ☑ *Obtained additional legal authority to collect money related to disciplinary cases, but needs approval of administrative procedures before it can implement the new authority.*
- ☑ *Is pursuing an increase in revenues from membership fees to help reduce projected deficits.*

As required by Chapter 342, Statutes of 1999, the Bureau of State Audits conducted a performance audit of the State Bar of California's (State Bar) operations covering January 1, 2004, through December 31, 2004. In planning this audit, we followed up on three principal areas identified during our 2003 audit: the State Bar's processing of disciplinary cases, cost recovery as part of processing disciplinary cases, and the use of mandatory and discretionary funds to support State Bar functions.

Our report concluded that the State Bar continued to monitor its backlog of disciplinary cases that resulted from its virtual shutdown in 1998. In addition, the State Bar's semiannual reviews of randomly chosen disciplinary cases in 2004 disclosed deficiencies similar to those found in its 2002 random reviews. To address these deficiencies and in response to our 2003 audit recommendations, the State Bar developed a brief checklist to guide staff in processing disciplinary cases. However, its staff did not always use the checklist and it is not sufficiently comprehensive. The State Bar also adopted a policy to spot check open disciplinary cases to ensure that staff are maintaining files properly and handling complaints correctly. However, we found that staff did not consistently perform the requisite number of spot checks and sometimes failed to document the results.

Further, the State Bar's recoveries of disciplinary costs and Client Security Fund payments remained low. Therefore, to subsidize these costs, it used a larger portion of the membership fees it collected than it would have if its recovery rates were higher. Although a law effective in January 2004 improved its ability to recover past and future costs, the State Bar has not yet been able to use this new authority because it is waiting for approval of certain administrative procedures by the California Supreme Court. Finally, the State Bar is pursuing a revenue increase to help reduce projected deficits in its general fund and Client Security Fund. Specifically, we found:

Finding #1: The State Bar continued to monitor its case backlog while seeing little change in the number of disciplinary cases it processed.

The State Bar processed almost the same number of cases through its intake and enforcement units in 2004 as it did in 2002. In addition, although it reported that its backlog of disciplinary cases increased to 540 cases in 2003, the backlog it reported at the end of 2004 was 402 cases, which is almost identical to the backlog at the end of 2002. Even though the State Bar maintains an "aspirational goal" of reducing the backlog to 250 cases, it believes that having a backlog of about 400 cases may reflect the norm.

We recommended that the State Bar continue its efforts to control its backlog of disciplinary cases.

State Bar's Action: Corrective action taken.

The State Bar reported that it has reorganized the Office of the Chief Trial Counsel, in part, to address structural and reporting issues that have historically contributed to the creation of the backlog. In particular, it eliminated the separate trial unit and investigation unit and created four trial and investigation units that it believes will result in greater teamwork in performing adequate investigations and preparing cases for trial. The State Bar also stated that, since September 1, 2005, its deputy trial counsel, rather than investigators, oversees all disciplinary investigations. By December 2005, the State Bar reported a reduced backlog of 315 cases, the lowest year-end backlog level since 1997 when the backlog was at 253 cases. By continuing to focus on the disposition of existing backlog cases and avoiding the roll-in of new cases into the backlog, it is the goal of the Chief Trial Counsel to further reduce the backlog to about 200 cases by the end of 2006.

Finding #2: The State Bar needs to fully implement its procedures and policies for monitoring disciplinary case processing.

The State Bar's random reviews of its disciplinary case files indicate that staff still have not consistently followed policies and procedures when processing complaints filed against its members. In particular, in its 2004 semiannual reviews of randomly chosen case files, the State Bar identified some of the same deficiencies as it identified in 2002 reviews. To address some of these issues, and in response to the recommendations we made in our 2003 report, the State Bar developed a checklist to ensure that staff complete important steps in processing complaints and include all necessary documents in every case file. Further, in 2004 the State Bar instituted a policy requiring team leaders to periodically spot check active files. However, we found that staff have not consistently used the checklist and it is not sufficiently detailed. In addition, we found little evidence of compliance with the spot-check policy.

We recommended that the State Bar:

- Establish a written policy requiring staff to maintain a checklist of the important steps involved in processing disciplinary cases and include all necessary documents in every case file, rather than relying on an informal instruction that the checklist be used.

- Develop a checklist that is more comprehensive than the current investigation file reminder, such as the tool that the audit and review unit uses when it randomly reviews disciplinary case files.

- Make supervisors responsible for ensuring that each case file includes a checklist and that staff use it.

- Enforce its policy of spot checking the files of active disciplinary cases and require team leaders to document the results of their spot checks.

State Bar's Action: Corrective action taken.

The State Bar reported that it has developed a more comprehensive checklist and directed its staff to begin using the checklist effective July 1, 2005. In addition, the State Bar stated that it has issued a policy directive that addresses the monthly random audits of open investigation files, as well as the requirement to document the results of the random audits using a checklist form developed for that purpose.

Finding #3: Changes in state law may improve the State Bar's recovery of disciplinary costs and Client Security Fund payments.

The State Bar's cost recovery rates in 2004 were comparable to its recovery rates in 2002; however, they remained low compared with the total amounts billed. Specifically, the State Bar's cost recovery rates in 2004 for discipline and the Client Security Fund were 40.5 percent and 10.7 percent, respectively. Therefore, the State Bar used a larger portion of its membership fees to subsidize its disciplinary activities and the Client Security Fund than it would have with a higher recovery rate. In the past, the State Bar had little success in recovering costs from disbarred attorneys or attorneys who resigned, in part, because it lacked specific authority to pursue recovery of debts under the Enforcement of Judgments Law. However, based on amendments to the Business and Professions Code, effective in January 2004, the State Bar now has the requisite legal authority, which may improve its ability to recover not only future costs but also some portion of the $64 million in billed costs that remain unrecovered since 1990.

To enable it to carry out the statute, the State Bar has proposed to the California Supreme Court that the California Rules of Court be amended. The proposed amendments, which the State Bar submitted to the supreme court in February 2005, would require the superior court clerk of the relevant county to immediately enter a judgment against an attorney for the amount the State Bar certifies the attorney owes for disciplinary costs or Client Security Fund payments. After obtaining the money judgment, the State Bar would be able to garnish wages or obtain judgment liens on real property the attorney owns. Until the Supreme Court approves the proposed procedures, the State Bar cannot exercise the money judgment authority.

We recommended that the State Bar prioritize its cost recovery efforts to focus on attorneys who owe substantial amounts related to disciplinary costs and payments from the Client Security Fund.

State Bar's Action: Partial corrective action taken.

The State Bar reported that it is still awaiting the Supreme Court's approval of the proposed rule of court for the procedures needed to begin filing of money judgments. In March 2006, the Clerk of the Supreme Court requested the State Bar to make certain nonsubstantive changes to the proposed rule of court and to resubmit its proposal. The State Bar's executive director expected approval of the changes by the board of governors in May 2006. The State Bar

also indicated that it continues to monitor the responses from disciplined attorneys to the demand letters that have been mailed in its two pilot projects—one targeting the most recently disciplined attorneys and another targeting the 100 disciplined attorneys who owe the most in disciplinary costs. As of April 2006, the State Bar reported that collections as a result of the first and second pilot projects have totaled $48,112 and $24,411, respectively. Further, the State Bar indicated that in each matter that remains unpaid, it continues retrieving relevant documents from the files of disciplined attorneys so that it can file requests for money judgments when the proposed rule is adopted.

The State Bar also indicated that it has attained a favorable ruling in the lawsuit that one disbarred attorney who received a demand letter for repayment of disciplinary costs had filed in federal court challenging the constitutionality of the amendments permitting the State Bar to enforce disciplinary costs as money judgments. However, the attorney has appealed and the matter is now pending in the Ninth Circuit.

Finally, the State Bar reported that it has completed its review of attorneys with court-ordered restitution from the list of the 100 attorneys owing the most in Client Security Fund reimbursements and reconciled the amounts these members owe. It found that Client Security Fund restitution was ordered only in one matter. Therefore, the State Bar believes that the benefit of the new collection enforcement authority will be largely prospective.

Finding #4: The State Bar is pursuing a revenue increase to help reduce projected deficits.

Based on the State Bar's financial forecast, the combined balance of its general fund, which accounts for activities related to the disciplinary system, and its Public Protection Reserve Fund, which was established to ensure the continuity of the disciplinary system, will sink into a deficit of $13.8 million by the end of 2008 unless revenues from membership fees increase.

The forecast assumes a significant increase in staff salaries and wages beginning in 2006 and no change in membership fees. For its general fund the State Bar predicts that expenses will exceed revenues starting in 2005, which will eventually use up the surplus in the general fund. The State Bar also predicts that its Client Security Fund, which it uses to help alleviate the financial losses suffered by clients of dishonest attorneys, will have a deficit by the end of 2006. To avoid projected deficits, the State Bar has proposed a bill that would increase its membership fees by $5 for active members and $95 for inactive members and would change the criteria for active members to qualify for a partial fee waiver. If approved, these changes would become effective on January 1, 2006.

We recommended that the State Bar continue to update its forecasts for key revenues and expenses as new information becomes available. For example, the State Bar should closely monitor the results of its enhanced collection enforcement authority and the benefits it may have on recovery of disciplinary costs and Client Security Fund payments.

State Bar's Action: Partial corrective action taken.

The State Bar reported that its fee bill for 2006 and 2007 was signed into law in September 2005. The authorized fees are slightly different than those discussed in the audit report. The State Bar indicated that its recently updated financial forecast for the general fund that includes 2005 actual operating results projects a modest surplus of $266,000 at the end of 2007. In addition, the State Bar indicated that it will continue to monitor key 2006 revenues and expenses on a quarterly basis, including monies collected through cost collection efforts, and will update its financial forecast accordingly.