Implementation of State Auditor's Recommendations

Audits Released in January 2006 Through December 2007

Special Report to
Assembly Budget Subcommittee #4—State Administration

February 2008 Report 2008-406 A4

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February 21, 2008 2008-406 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 an appendix that identifies monetary benefits that auditees could realize if they implemented our recommendations, and 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 2006 through December 2007, 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 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 to provide a response beyond one year or we may 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 2008.

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

DNA Identification Fund

Improvements Are Needed in Reporting Fund Revenues and Assessing and Distributing DNA Penalties, but Counties and Courts We Reviewed Have Properly Collected Penalties and Transferred Revenues to the State

REPORT NUMBER 2007-109, NOVEMBER 2007

The Department of Justice's, State Controller's Office's, and Administrative Office of the Courts' responses as of November 2007

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits to review the implementation of the DNA act—specifically, the collection and management of money in county and state DNA funds. The audit committee noted that since the DNA act became effective, revenues associated with it were significantly lower than expected. Additionally, the Legislative Analyst's Office suggested that the revenue shortfall might be the result of counties not collecting the DNA penalty assessments or receiving only partial payments. Further, information posted on the Department of Justice (Justice) Web site showed that many counties, including five of the 10 largest, did not report collecting any DNA fund money for 2005. Consequently, the audit committee was concerned that the State may not be receiving its fair share of DNA fund money and that counties may not be using the funds as intended.

Finding #1: Reporting of data on county DNA identification funds needs to improve.

The DNA act requires the courts to levy a penalty of $1 for every $10, or fraction thereof, on all fines, penalties, or forfeitures imposed and collected by the courts for all criminal offenses, including violations of the vehicle code but excluding parking violations (initial DNA penalty). The DNA act also requires each county's board of supervisors to submit an Annual County DNA Identification Fund Report (annual report) to the Department of Justice (Justice) and the Legislature detailing collection and expenditure information related to the initial DNA penalty. Further, the DNA act requires Justice to post data from the annual reports on its Web site. In July 2006 the DNA act was amended to levy an additional DNA penalty on all criminal and vehicle violations except parking violations (additional DNA penalty).

However, state law does not require counties to report collections related to the additional DNA penalty. Consequently, the information the counties report to Justice and the Legislature is incomplete and, as a result, the State cannot be fully assured that the counties are assessing and collecting all required DNA penalties. Based on our review of records maintained by the State Controller's Office (state controller), counties transferred to the State about $2.3 million in additional DNA penalties from July 2006, the month the additional penalty became effective, through December 2006, an amount that is not reflected on the Justice Web site. Further, the state controller's records also show that 11 counties did not report transferring any money from the additional DNA penalty to the State for 2006. We

Audit Highlights . . .

Our review of the implementation of Proposition 69, the DNA Fingerprint, Unsolved Crime, and Innocence Protection Act (DNA act) revealed that:

» ***State law does not require counties to report collections related to the additional DNA penalty imposed by the July 2006 amendment to the DNA act; therefore, interested parties would not be able to obtain a complete picture of all the DNA penalty money collected and transferred to the State.***

» ***Information available on the Department of Justice's Web site as of June 2007 showed that 22 counties had not transferred any DNA money to the State in 2005 and 24 did not do so in 2006; however, based on the State Controller's Office's records, these counties actually transferred to the State $1.6 million in 2005 and $3.8 million in 2006.***

» ***Although there were no significant errors in assessing and distributing DNA penalties at the three counties we reviewed, some weaknesses in the courts' automated case management systems and internal controls resulted in minor errors in the assessment and distribution of DNA penalties.***

contacted each of these counties and were informed by representatives of nine of the 11 counties that they combined money they collected from the additional DNA penalty with their collections of the initial DNA penalty rather than identify their collections separately on the documentation sent to the state controller. Moreover, three of the nine counties indicated that they failed to transfer 100 percent of their collections to the State, as required by law. Rather, they only transferred 70 percent, the amount applicable to the initial DNA penalty. Additionally, an official from one county stated that, although the court was assessing and collecting the additional DNA penalty, due to a coding error, the county did not transfer its additional DNA penalty collections to the State until March 2007. Finally, an official from the court in the remaining county acknowledged that it did not begin assessing the additional penalty until September 2007.

Additionally, many counties failed to submit annual reports in 2005 and 2006. In particular, as of June 2007, 22 counties had not submitted the required annual reports to Justice for 2005 and 24 counties had not submitted the reports for 2006. Rather than report that the counties had failed to submit annual reports, the Justice Web site indicated that they had not transferred any DNA fund money to the State. However, based on records from the state controller, all but two counties had transferred certain DNA fund money to the State in 2005, and only one county failed to make the required transfers in 2006. The counties that did not submit annual reports on their 2005 collections actually transferred almost $1.6 million to the State, and the counties that did not submit reports on their 2006 collections transferred almost $3.8 million. Because the Justice Web site shows those counties as not transferring any money to the State, anyone attempting to use the data might erroneously conclude that many counties were not assessing any DNA penalties and that the State was not receiving money it was owed.

We recommended that the Legislature consider revising state law to require counties to include in their annual reports information on the additional DNA penalty established by Chapter 69, Statutes of 2006.

We also recommended that the Administrative Office of the Courts (AOC) contact the courts in the counties that did not report transferring to the State any money or only part of the money for the additional DNA penalty to determine whether they are appropriately assessing the penalty. Additionally we recommended that the state controller contact the auditor-controllers in the counties that did not report transferring to the State any money or only part of the money for the additional DNA penalty to ensure that counties and courts correctly assess, collect, and transfer the money to the State.

Finally, because state law requires Justice to make county-reported data available on its Web site, we recommended that Justice take several steps to ensure that data on county DNA fund activities are accurate. We recommended that Justice annually notify counties that they are statutorily required to submit reports on or before April 1 to the Legislature and to contact each county that does not submit an annual report by the deadline. Additionally, we recommended that Justice establish policies and procedures for posting county data on its Web site and clearly indicate on its Web site any county that failed to submit an annual report.

Legislative Action: Unknown

AOC's Action: Pending.

The AOC stated that it would take appropriate action if needed.

State Controller's Action: Pending.

The state controller agrees there needs to be greater communication on the subject of DNA revenue remittances and will inform all county auditor-controllers of the specific requirements of the DNA penalties. Additionally, the state controller's staff will ensure this subject is addressed at the next meeting between the state controller and the county auditor-controllers.

Justice's Action: Partial corrective action taken.

Justice stated that it would begin sending out form letters every February to all counties reminding them that the report for the previous year is due April 1. Additionally, Justice stated that a formal letter from the attorney general would be sent in May to those counties that have not submitted an annual report by the April 1 deadline.

Justice indicated that it is also preparing internal policies and procedures specific to posting county DNA fund data on it Web site. These policies and procedures will dictate that Web-postings will reflect future collections as "not reported" should a county fail to submit an annual report by April 1.

Finding #2: Courts need to improve their methods of ensuring the accuracy of DNA penalty assessments and distributions.

Although we did not discover any significant errors in the transactions we reviewed for the county superior courts of Los Angeles, Orange, and Sacramento, we identified weaknesses in data entry and processing internal controls that could affect many of the DNA penalties processed by all three superior courts. The monetary impact of the errors ranged from 1 cent to $54 per case. While not individually significant, the potential volume of the errors could prove to be material in amount.

For example, the DNA penalty distributions calculated by the case management system used by the Orange County Superior Court (Orange court) resulted in rounding errors affecting 22 of the 40 cases we reviewed. According to an official of the AOC, the case management system the Orange court uses is a precursor to the case management system that the AOC plans to eventually implement statewide. Additionally, based on a report issued by the Judicial Council of California (Judicial Council), California Superior Court criminal case dispositions totaled more than 6.4 million statewide for fiscal year 2005–06. Not every case disposition—the final outcome of a case, such as a case dismissal or criminal sentencing—results in penalty assessments. Nonetheless, the magnitude of the errors will be greatly increased unless the AOC ensures that the cause of the rounding errors in the precursor system is identified and corrected before it implements the new statewide system. Moreover, when an individual was allowed to make installment payments, the Orange court's case management system did not always distribute the payments according to the priority order established by law.

We also identified a data entry error related to a specific type of motor vehicle code offense occurring at one location of the Los Angeles County Superior Court (Los Angeles court). The resulting error appears to have been committed by one court employee and was recurring over at least a 12-month period between 2005 and 2006. Additionally, for three other cases we reviewed involving another Los Angeles court location, the court did not properly assess the DNA penalty for a particular type of misdemeanor offense. Finally, we found that the Sacramento County Superior Court (Sacramento court) erroneously transferred $292,000 to the State for payments received for various vehicle code violations. Because the relevant violations had resulted in the court allowing the offenders to attend traffic school, by law the county should have retained the payments received from the offenders.

We recommended that the AOC work with the Orange court to estimate the total dollar effect of the rounding errors in calculating the penalty assessment distribution to determine whether it will have a significant financial impact on the State. If the AOC determines that the impact will be significant, it should ensure that the Orange court makes the necessary modifications to the distributions calculated by its case management system. Further, as it proceeds with developing the statewide case management system, the AOC should ensure that the system correctly distributes payments to the appropriate funds in accordance with all applicable laws and regulations. The AOC should also ensure that the Orange court reevaluates and makes necessary corrections to the distribution priority order programmed into its case management system. Additionally, the AOC should ensure that the Los Angeles court corrects any manual coding errors and strengthens internal controls over data entry. Finally, the AOC should ensure that the Sacramento court continues its efforts to correct any overpayments made to the state DNA fund.

AOC's Responses:

Orange County's Action: Pending.

The AOC stated that the Superior Court of Orange County would increase the field definition for the number of decimal points used in rounding in order to accommodate appropriate precision for fund distribution. The estimated time of completion is March 31, 2008.

The AOC also stated that the Superior Court of Orange County will evaluate its current distribution priorities programmed into its case management system to ensure that they are in compliance with applicable state laws. As discrepancies are noted, the appropriate action will be taken to correct the distribution priority for current and future distributions. The estimated time of completion is January 31, 2008.

Los Angeles County's Action: Corrective action taken.

The AOC stated that the Superior Court of Los Angeles County agrees with our recommendation and has taken steps to ensure that manual coding cashier errors are identified and corrected.

Sacramento County's Action: Partial corrective action taken.

The AOC indicated that the Superior Court of Sacramento County concurs with our finding. The superior court stated that it has made the necessary corrections to processes and database systems to properly capture and distribute traffic school and red light penalties going forward.

Concerning the incorrect distributions of traffic school and red light collections, the Superior Court of Sacramento County has made corrections to an estimated 25 percent of the amounts. The process of reversing all the incorrect distributions will take a number of months. The superior court estimates that corrections to prior distributions will be completed by March 2008.

California Exposition and State Fair

Investigations of Improper Activities by State Employees, July 2006 Through January 2007

INVESTIGATION I2006-0945 (REPORT I2007-1), MARCH 2007

Investigative Highlight . . .

An official at the California Exposition and State Fair (Cal Expo) violated conflict-of-interest laws when he sold his personal vehicle to Cal Expo.

California Exposition and State Fair's response as of October 2007

We investigated and substantiated an allegation that Official A, a high-ranking officer at the California Exposition and State Fair (Cal Expo), violated conflict-of-interest laws by participating in a state purchasing decision from which he received a personal financial benefit.

Finding: Official A violated state conflict-of-interest laws when he made or directed a governmental decision that authorized Cal Expo to purchase his personal vehicle.

Official A sold his personal vehicle to Cal Expo in July 2005. Because he was involved in the decision to make this purchase while acting in his official capacity and because he derived a personal financial benefit from this transaction, Official A violated the Political Reform Act of 1974 (act) and Section 1090 of the California Government Code (Section 1090).

Under the act, public officials at all levels of state government are prohibited from making, participating in making, or in any way attempting to use their official positions to influence a governmental decision in which they know or have reason to know they have a financial interest. Section 1090 prohibits a public official from participating in the formation of a contract or making a purchasing decision in which he or she has a financial interest.

Although Official A did not sign the initial purchase order authorizing the transaction, he met with Official B and Manager 1 before the purchase to discuss whether Cal Expo should acquire the vehicle. Official A, along with Official B and Manager 1, agreed Cal Expo should purchase the vehicle. Official B, who reports directly to Official A, subsequently approved a purchase order, and Manager 1, who reports directly to Official B, certified that he received the vehicle. Official A subsequently submitted an invoice to Cal Expo for the sale, and Cal Expo paid Official A $5,900 with a check containing Official A's preprinted signature.

More than a year after it purchased the vehicle, Cal Expo became aware that the transaction was potentially a violation of the law and subsequently reversed the transaction by returning the vehicle to Official A and requiring him to pay back the $5,900. However, Cal Expo's actions were not consistent with the remedies available under state law because Cal Expo was entitled to recover the $5,900 it paid for the vehicle and to retain the vehicle itself. By simply returning the vehicle to Official A, Cal Expo did not pursue the remedy that would have provided greater protection of the State's interest.

Cal Expo's Action: Corrective action taken.

In March 2007 Cal Expo reported that it believed invalidating the transaction and returning the vehicle were appropriate remedies. It also believed, because of Official A's record, that formal disciplinary action and criminal prosecution were not warranted. However, Cal Expo shared our concern that this serious ethical breach merited further action. In July 2007 Cal Expo reported that its Board of Directors, management, and supervisory staff had completed an ethics training course. It also reported that at the Board of Directors' meeting in September 2007, it approved a new accounts payable policy, requiring two officials to sign any checks made payable to Cal Expo employees other than for travel reimbursements and prohibiting Cal Expo officials from signing any checks written to themselves.

Department of Conservation

Investigations of Improper Activities by State Employees, July 2006 Through January 2007

INVESTIGATION I2006-0908 (REPORT I2007-1), MARCH 2007

Department of Conservation's response as of September 2007

We investigated and substantiated an allegation that an employee with the Department of Conservation (Conservation) engaged in various activities that were incompatible with his state employment, including using the prestige of his state position and improperly using state resources to perform work for the benefit of his spouse's employer, a charitable organization.

Finding #1: The employee misused state resources to engage in improper activities.

We found that the employee misused state resources to engage in numerous activities that were incompatible with his state employment, including misusing the prestige of his state position. We believe that the nature and extent of these improper activities caused a discredit to the State. Specifically, the employee engaged in the following improper activities:

- Failed to disclose stock ownership in oil industry companies and regulated companies.[1]
- Owned stock in a company at the time he issued permits to that company.
- Used state time and resources for fundraising.
- Solicited charitable contributions from oil industry companies and regulated companies.
- Used his state position to assist a charity.
- Requested and received personal discounts from a state vendor.
- Sent more than 65 e-mails that were insubordinate or of a nature to discredit the State.

The employee owns or has owned stock in a number of oil industry companies, including at least two regulated companies (Company A and Company J). However, he failed to disclose his ownership of stock in these companies, in violation of the Political Reform Act of 1974 (act).

As required by the act, Conservation requires the employee, who works in Conservation's Division of Oil, Gas & Geothermal Resources (division), and others in his job classification to annually complete

[1] The employee is required to disclose his stock ownership in companies regularly engaged in oil and gas exploration and related industries (oil industry companies), which includes regulated companies.

Investigative Highlights . . .

An employee at the Department of Conservation:

» *Failed to disclose his stock ownership in at least 18 instances.*

» *Owned stock in two companies at the time he made business decisions affecting those companies.*

» *Misused state resources to assist his spouse's employer.*

» *Used his state e-mail to directly solicit donations from oil industry and regulated companies.*

» *Used the prestige of his state position to obtain discounts on his personal cell phone purchases.*

» *Sent more than 65 e-mails that were insubordinate or were of such a nature to cause a discredit to the division.*

In addition, the employee's manager failed to adequately monitor the employee's improper activities and failed to disclose his own stock ownership in at least seven instances.

statements of economic interests because these employees have the authority to approve permits that allow companies to extract or produce oil or geothermal resources. Accordingly, the employee, his manager, and others in their job classifications are required to include on their statements of economic interests any investments in, interests in business positions in, and income from any business entity of the type that may be affected by their decisions. This includes, but is not limited to, stock ownership with a value of $2,000 or more in businesses that are regularly engaged in the extraction and/or production of oil, gas, or geothermal resources.

We obtained the employee's statements of economic interests for each year from 2000 to 2005. In each statement, the employee certified under penalty of perjury that he had no reportable business interests. However, information the employee stored on his state computer that he later confirmed as accurate indicated that the employee failed to disclose reportable investments every year during this time period. In particular, we found for those years at least 18 instances where the employee failed to disclose that his stock ownership in various companies exceeded $2,000 in value.

In addition, we believe the employee conducted himself in a questionable manner when he communicated with and approved permits for Company A, a company whose stock he owned at the time he approved its permit requests. Specifically, we believe that in doing so the employee may have violated the common law doctrine against conflicts of interest (doctrine). Similarly, we believe he also violated the doctrine when he made business decisions affecting Company B, the division's vendor for cellular phone services, while he owned stock in that company. The doctrine provides that a public officer is implicitly bound to exercise the powers conferred on him with disinterested skill, zeal, and diligence and primarily for the benefit of the public. Because he owned stock at the same time he approved permits for Company A and made purchases in his state capacity from Company B, we question whether the employee was able to make these business decisions with disinterested skill for the primary benefit of the State.

Further, we found that the employee misused his state e-mail—as well as other state resources—in a number of ways, and engaged in activities that were incompatible with his state employment while assisting his spouse in securing contributions on behalf of her employer, a charitable organization (Charity 1) in various capacities. These activities include soliciting donations from regulated companies even though he had been admonished for doing so in the past, and using his state position to facilitate Charity 1's potential purchase of a property on which he previously performed regulatory work.

The employee used his work e-mail account to send or receive more than 340 e-mails involving discussions of Charity 1 activities and events over the three-year period we reviewed. Nearly 80 of these e-mails involved soliciting donations for Charity 1 and in several instances he directly solicited donations from either oil industry or regulated companies. Many of the 340 e-mails indicate that the employee spent considerable state time and resources when serving as co-chairperson for an annual sponsorship event benefiting Charity 1 by assisting in planning and organizing the event and soliciting sponsorship donations from regulated and other oil industry companies for the event.

The employee also misused his state e-mail and improperly used his state position to facilitate Charity 1's attempt to purchase property from a property owner with whom he had previously interacted in his regulatory capacity as a state employee. The employee violated state law and Conservation's policy prohibiting its employees from using the prestige of their state positions for the gain of themselves or others when he contacted the property owner on behalf of Charity 1.

Moreover, the employee serves as the contact for the division's vendor for cell phone services, Company B. In this capacity, he has regular dealings with representatives of Company B. On two separate occasions the employee requested Company B to waive a $35 fee associated with his personal cell phone purchases. In his e-mail requests, the employee informed Company B that a large number of Conservation offices switched to Company B based on his recommendations. One could easily surmise from this request that Company B may have felt compelled to provide the discount in exchange for his continued efforts to recommend Company B to other Conservation offices. The employee's e-mail records show that Company B's representative agreed to waive the fee on both occasions.

Finally, our review of the employee's e-mail records also indicates that he regularly misused his state e-mail and engaged in a pattern of behavior that likely could be considered insubordinate or apt to cause a discredit to the State. Specifically, for the three-year period we reviewed, the employee sent or received more than 130 e-mails regarding personal financial matters. Most of these e-mails pertain to the potential value of specific stocks. At least 15 of them involved discussions of potential investments in either the oil industry or oil and gas industry companies. Further, we found that the employee sent more than 65 e-mails to coworkers, superiors, representatives of oil industry and regulated companies, and others that we believe were insubordinate or were of such a nature as to discredit the division.

Conservation's Action: Partial corrective action taken.

Conservation reported that it pursued adverse action against the employee and he resigned from state service. In addition, Conservation reported it has taken action to ensure that similar misconduct is not repeated. Included in its corrective action, Conservation stated that it has:

- Developed a web page that its employees can use to review ethics and conflict-of-interest requirements.
- Established an internal ethics advisory panel.
- Required all employees who complete statements of economic interests to complete the Attorney General's online ethics training seminar.
- Continued an internal investigation to ensure that the misconduct is not more widespread than identified in our report.

Finding #2: The manager failed to adequately monitor the employee and failed to disclose his own interests in oil industry companies.

Information the employee stored on his state computer indicates that the manager should have known that the employee was involved in charitable functions involving regulated companies and Charity 1. These documents show that the manager participated in the annual charity event in 2005 and 2006 for which the employee and a representative of a regulated company were co-chairpersons in 2006. Additionally, these documents indicate that nine oil industry companies were sponsors for the event. We determined that six of them had previously submitted applications to the manager's district office for approval. Thus, it appears that the manager was aware—or should have been aware—that the employee was again soliciting donations from the regulated companies.

Documents stored on the employee's state computer also indicate that Company L, a company engaged in an industry related to oil and gas exploration, paid the manager's $150 entry fee for the annual charity event in 2006. When we questioned the manager, he stated that he was not certain whether Company L paid his entry fee but said he did not pay the fee. The manager added that he also did not pay for his entry into the previous year's event and stated that it was not uncommon for oil industry companies to pay for his entry into similar events. When we reviewed information relating to the annual charity event held in 2005, we found indications that Company M, which has submitted applications to the manager's office for his approval, paid his entry fee for the event. By accepting gifts from companies his office regulates, the manager may have violated conflict-of-interest laws and policies that prohibit a state employee from receiving any gift from anyone seeking to do business of any kind with the employee or his department under circumstances from which it reasonably could be substantiated that the gift was intended to influence the employee or was intended as a reward for official actions performed by the employee.

Finally, in the course of our interview, the manager also acknowledged that he has owned stock in a regulated company as well as in other oil and gas industry companies. Specifically, the manager informed us that in 2004 he held stock exceeding $2,000 in value in three oil and gas industry companies, including Company A, and four oil and gas industry companies in 2005. When we asked why he did not report his ownership of stock in regulated companies on his annual statement of economic interests, the manager responded that he did not believe he owned enough to require him to report them.

Conservation's Action: Partial corrective action taken.

In addition to taking the corrective actions Conservation reported for finding #1, it also placed the manager on administrative leave while it further investigates his actions.

Medical Board of California's Physician Diversion Program

While Making Recent Improvements, Inconsistent Monitoring of Participants and Inadequate Oversight of Its Service Providers Continue to Hamper Its Ability to Protect the Public

REPORT NUMBER 2006-116R, JUNE 2007

State and Consumer Services Agency's response as of December 2007

The Joint Legislative Audit Committee requested the Bureau of State Audits review the effectiveness and efficiency of the Medical Board of California's (medical board) Physician Diversion Program (diversion program). In our review, we found that although the diversion program had made many improvements since the release of the November 2005 report of an independent reviewer, known as the enforcement monitor, there were still some areas in which the program needed to improve in order to adequately protect the public. For instance, although case managers appeared to be contacting participants on a regular basis and participants generally appeared to be attending group meetings and completing the required amount of drug tests, the diversion program did not adequately ensure that it received required monitoring reports from its participants' treatment providers and work-site monitors.

In addition, although the diversion program had reduced the amount of time it takes to admit new participants into the program and begin drug testing, it did not always respond to potential relapses in a timely and adequate manner. Specifically, the diversion program did not always require a physician to immediately stop practicing medicine after testing positive for alcohol or a nonprescribed or prohibited drug. Further, of the drug tests scheduled in June and October 2006, 26 percent were not performed as randomly scheduled. Additionally, the diversion program did not have an effective process for reconciling its scheduled drug tests with the actual drug tests performed and did not formally evaluate its collectors, group facilitators, and diversion evaluation committee members to determine whether they were meeting program standards. Finally, the medical board, which is charged with overseeing the diversion program, had not provided consistently effective oversight.

Medical Board's Action: Discontinued the diversion program.

In July 2007 the medical board met and determined that it would allow the diversion program to sunset on June 30, 2008. Due to the termination of the program, the medical board did not address individual audit report recommendations in its responses to the audit. Rather, the medical board described its transition plan, which was approved by the board in November 2007. Key components of the plan are outlined on the following pages:

Audit Highlights . . .

Our review of the Medical Board of California's (medical board) Physician Diversion Program (diversion program) revealed the following:

- *Case managers are contacting participants on a regular basis and participants appear to be attending group meetings and completing drug tests, as required.*
- *The diversion program does not adequately ensure that it receives required monitoring reports from its participants' treatment providers and work-site monitors.*
- *The diversion program has reduced the amount of time it takes to bring new participants into the program and begin drug testing, but the timeliness of testing falls short of its goal.*
- *The diversion program has not always required a physician to immediately stop practicing medicine after testing positive for alcohol or a nonprescribed or prohibited drug, thus putting the public's safety at risk.*
- *Twenty-six percent of drug tests in June and October 2006 were not performed as randomly scheduled.*
- *The diversion program's current process for reconciling its scheduled drug tests with the actual drug tests performed needs to be improved.*

continued on next page . . .

» *The diversion program has not been formally evaluating its collectors, group facilitators, and diversion committee members to determine how well they are meeting program standards.*

» *The medical board has not provided consistently effective oversight of the diversion program.*

Self-referred participants:

- The diversion program will no longer admit new, self-referred physicians into the program.
- Self-referred participants with three years of sobriety will be referred to a Diversion Evaluation Committee (DEC) for a determination of whether the individuals can be deemed to have completed the program.
- On June 30, 2008, self-referred participants with less than three years of sobriety will be sent a letter stating that the diversion program is inoperative and encouraging the physicians to find another monitoring or treatment program.

Board-referred participants:

- The medical board will notify individuals seeking admission into the diversion program in lieu of disciplinary action (board-referred) that the program will be inoperative June 30, 2008, and, at that time the medical board will refer the individuals to the Attorney General's Office and enforcement for further action. Being made fully aware of this condition, participants will be given the choice of entering the program or proceeding through the enforcement process.
- Current, board-referred participants with three years of sobriety will be referred to a DEC for a determination of whether the individuals can be deemed to have completed the program.
- On January 1, 2008, board-referred participants with less than three years of sobriety will be sent a letter stating that the diversion program will be inoperative as of June 30, 2008, and that they must find another program that meets the protocols of the diversion program. In addition, the other program must be willing to report to the Medical Board's chief of enforcement on a regular basis and to immediately notify the board of any positive drug tests.

Board-ordered participants:

- The medical board will no longer approve a stipulation that requires participation in the diversion program as a condition of a disciplinary order or issuance of a probationary license.
- On July 1, 2008, the diversion program condition in all disciplinary orders will become null and void and will no longer be considered a condition of probation. However, individuals will still be required to abstain from drugs and alcohol and must submit to drug testing. Staff will continue to monitor the random drug tests of these individuals.

Out-of-state participants:

Staff will continue to liaison with programs in other states to ensure that out-of-state participants comply with that respective state's program until completion.

Medical Board of California

It Needs to Consider Cutting Its Fees or Issuing a Refund to Reduce the Fund Balance of Its Contingent Fund

REPORT NUMBER 2007-038, OCTOBER 2007

Medical Board of California's response as of January 2008

Section 2435 of the Business and Professions Code (code) directs the Bureau of State Audits (bureau) to review the Medical Board of California's (medical board) financial status and its projections related to expenses, revenues, and reserves, and to determine the amount of refunds or licensure fee adjustments needed to maintain the reserve legally mandated for the medical board's contingent fund.

The medical board assesses fees for physicians and surgeons (physicians) according to rates and processes established in the code. In 2005, passage of Senate Bill 231 increased physicians' license fees (fees) from a maximum rate of $600 to $790. In addition to establishing the rate, the code also states that the Legislature expects the medical board to maintain a reserve, or fund balance, in its contingent fund equal to approximately two months of operating expenditures.

Finding #1: The medical board does not have the flexibility to adjust fees because they are established in law.

The code requires the medical board to maintain a fund balance that would cover approximately two months of operating expenditures. The code also suggests that if the fund balance becomes excessive, the medical board should take action to reduce the fund balance. However, the code does not provide the medical board the flexibility to adjust fees.

We recommended that the medical board seek a legislative amendment to Section 2435 of the code to include language that allows it the flexibility to adjust physicians' license fees when necessary to maintain its fund balance at or near the mandated level.

Medical Board's Action: Partial corrective action taken.

The medical board said that it approved a motion in November 2007 to seek legislation to allow flexibility in the initial licensing and renewal fees. In January 2008 Assembly Bill 547 was amended to include language giving the medical board the flexibility to set these fees up to a maximum of $790 and, as of January 2008, was still in committee.

Audit Highlights . . .

Our review of the Medical Board of California's (medical board) financial status and fund balance revealed that:

- *The fund balance of the medical board's contingent fund increased by $6.3 million, to $18.5 million, in fiscal year 2006–07. This represented 4.3 months of reserves, more than 100 percent above the reserve level mandated in the law.*
- *The recent increase in the fund balance resulted from variances between actual and estimated expenditures.*
- *The medical board estimates that its months of reserves will drop to 1.5 months by June 30, 2012, assuming that it spends all of its appropriations in each of the next five fiscal years.*
- *However, based on the medical board's historical experience of overestimating expenditures, we estimate that it will have 3.8 months of reserves by June 30, 2012, unless it issues refunds or decreases license fees for physicians.*

Finding #2: The fund balance of the medical board's contingent fund increased significantly in fiscal year 2006–07, resulting in reserves well above mandated levels.

The medical board's fund balance increased by $6.3 million to $18.5 million in fiscal year 2006–07, resulting in an increase in months of reserves to 4.3 months. The increase was caused mostly by the variance between estimated and actual expenditures in fiscal year 2006–07, primarily related to a planned expansion of medical board programs that was not fully realized in that year.

We believe the fund balance is unlikely to return to the level legally mandated unless fees are reduced or refunded. In particular, while the medical board's estimated revenues consistently approximated actual revenues in the last four fiscal years, the medical board has consistently overestimated expenditures by at least $2 million each year over the same period. Based on the medical board's future revenue and expenditure estimates, adjusted downward by $2 million for the expenditure difference just described, we estimate that the medical board still would have 3.8 months of reserves on June 30, 2012.

We recommended that the medical board consider refunding physicians' license fees or, if successful in gaining the flexibility to adjust its fees through an amendment to existing law, consider temporarily reducing them to ensure that its fund balance does not continue to significantly exceed the level established in law.

Medical Board's Action: Pending.

The medical board said it considered reducing or refunding license fees but instead initiated several other actions that it stated would bring its fund balance into line with mandated levels. These are:

- Seek legislation to increase the mandated two-month reserve to four or six months.
- Seek budget authority to reestablish the Operation Safe Medicine Unit, to expand the Probation Program, and to replace its information technology infrastructure.
- Transfer $500,000 to the Health Profession Education Foundation to assist with the funding of a loan repayment program.

Batterer Intervention Programs

County Probation Departments Could Improve Their Compliance With State Law, but Progress in Batterer Accountability Also Depends on the Courts

REPORT NUMBER 2005-130, NOVEMBER 2006

Five county probation departments' responses as of November and December 2007

State law requires an individual who is placed on probation for a crime of domestic violence to complete a 52-week batterer intervention program (program) approved by a county probation department (department). The programs are structured courses designed to stop the use of physical, psychological, or sexual abuse to gain or maintain control over a person such as a spouse or cohabitant. The Joint Legislative Audit Committee requested that the Bureau of State Audits examine the extent to which the various entities involved in batterer intervention—including programs, departments, and courts—hold convicted batterers accountable. Specifically, we were asked to review how the departments and courts responded to a sample of progress reports, allegations, or other information from the programs. We were also asked to determine how well a sample of departments oversee programs.

Finding #1: Many batterers do not complete their required programs, and the extent to which they are held accountable varies.

Based on statistics provided by the departments and our review of a sample of 125 batterers, only about half of the batterers required to complete a program actually do so. In reviewing department responses to violations committed by the 125 batterers, we found that some departments we visited counseled and referred batterers back to programs after they had been terminated for violations, rather than notifying the courts as required by state law. Because only two batterers in our sample ever completed a program after committing three or more violations, we questioned whether this practice only delays the inevitable court-imposed consequences of jail time or probation revocation. Further, some courts notified of violations simply returned batterers to programs without imposing any additional jail time, even though at times the batterer had multiple prior violations. We questioned whether this practice may be sending the unintentional message to batterers that they can avoid the program requirement without any significant penalty for doing so.

Although the most frequent violation involved noncompliance with attendance policies, the departments we reviewed had various policies regarding program attendance, and all were more lenient than statutory provisions, which allow for only three absences for good cause. In discussing their policies, departments cited the need for greater flexibility in attendance policies to allow as many batterers as possible to complete their assigned programs. In addition, the counties of some of the departments we visited have implemented a practice of having batterers make regular appearances to have their progress reviewed by the court. This appears to provide for better batterer accountability and may improve program outcomes.

Audit Highlights . . .

Our review of batterer intervention programs (programs) in California revealed the following:

- *Only about half of batterers complete a program as required by state law.*
- *Only two batterers in our sample of 125 ever completed a program after committing three or more violations of their program or probation terms.*
- *The county probation departments (departments) we visited had various attendance policies, and all were more lenient than statutory provisions, which allow for only three absences for good cause.*
- *Rather than notifying the courts as required by state law, some departments are counseling and referring batterers back to programs after they have been terminated for violations.*
- *Courts sometimes do not impose any consequences on batterers, even those with multiple prior violations.*
- *On-site program reviews required by statute are not being performed consistently.*

We recommended that the departments, in conjunction with the courts and other interested county entities, jointly consider taking the following actions:

- Establish and clearly notify batterers of a set of graduated consequences that specify minimum penalties for violations of program requirements or probation terms. The nature of the violation, as well as the number of previous violations, should be taken into consideration when establishing the consequences.

- As part of these graduated consequences, establish a limit to the number of violations they allow before a batterer's probation is revoked and he or she is sentenced to jail or prison.

- Eliminate the practice of having probation officers counsel and direct batterers back to programs in which they failed to enroll or from which they have been terminated for excessive absences, and establish a consistent practice of notifying the court of such violations, allowing the court to set the consequence for the violations.

- If they have not already done so, implement a practice of regular court appearances in which batterers receive both negative and positive feedback on program compliance.

- Require programs to submit progress reports to the courts at the frequency specified by law.

We also recommended that the Legislature consider revising the attendance provisions included in the law to more closely align with what departments and courts indicate is a more reasonable standard and assess whether probation and the program requirement are an effective deterrent for future acts of domestic violence for individuals who commit acts of domestic violence while in programs or after completing a program.

Butte County Probation Department's Action: Corrective action taken.

After consideration of the report recommendations, the Butte department stated that it believes weekly pre-court and quarterly roundtable discussions among the judge, deputy district attorney, defense counsel, probation officers, and treatment program representatives help develop the consistency of consequences the audit report recommends. The Butte department indicated that its batterers are brought before the court for any failure to abide by the treatment program. Recommendations related to progress reports and regular court appearances were not directed to the department in Butte County because we did not discover any deficiencies related to these areas at this department during the audit.

Los Angeles County Probation Department's Action: Partial corrective action taken.

In its original response to the audit, the department in Los Angeles County, in consultation with the court in the county, indicated that it believes that the recommendation related to graduated consequences interferes with the discretion of individual judges and that regular court appearances would only be necessary for court-supervised probationers, not batterers on formal probation. We have not received any further communications from the county on this matter. Recommendations related to progress reports and court notifications of violations were not directed to the department in Los Angeles County because we did not discover any deficiencies related to these areas at this department during the audit.

Riverside County Probation Department's Action: Corrective action taken.

The Riverside department provided us with an outline of the graduated consequences the court in the county has established to guide its bench officers in their handling of treatment program attendance and enrollment violations for misdemeanor domestic violence cases in the county. Among other things, the outline indicates that on the fourth violation, probation will be terminated and the individual will serve extensive jail time.

The Riverside department explained that, because of an overburdened court system, the court is not able to have regular court appearances for all batterers and expects the probation department to attempt to resolve minor violations before returning the case to the court. Consequently, the department explained that it is in the process of implementing a policy in which probation officers could reinstate batterers into a program after a first-time attendance or enrollment violation but would provide written notification to the court of this action. The court could then choose to set the matter for further hearing if need be. The recommendation related to progress reports was not directed to the department in Riverside County because we did not discover any deficiencies related to this area at this department during the audit.

San Joaquin County Probation Department's Action: Corrective action taken.

The San Joaquin department stated that, although it was not able to obtain consensus from the court on a set of graduated consequences for batterers, it did develop a set of graduated consequences for its probation officers to follow in making recommendations to the court following violations of probation. These consequences include a recommendation that a batterer's probation be terminated, with all remaining jail time imposed, for the fourth violation of probation.

The San Joaquin department stated that it has directed probation officers to refer batterers back to programs only after a violation of probation has been filed with the court and the court has directed the batterer back to the probation department. Due to the limited resources of the court, the department indicated that regular court appearances are not feasible at this time. Additionally, the San Joaquin department stated that the courts have requested that required progress reports from the programs be sent to the department and the department has assumed the responsibility of notifying the court of any required action.

San Mateo County Probation Department's Action: None.

The original and subsequent responses from the San Mateo department did not indicate that it jointly considered the report's recommendations with the court and other interested county entities. Rather, the department responded that to its knowledge the court has not established a set of graduated consequences but that it is confident that all probationers are consistently held accountable for probation violations. The department then added that its current practices related to notifying the court of violations and referring batterers back to programs will continue as they are until they are changed. Recommendations related to progress reports and regular court appearances were not directed to the department in San Mateo County because we did not discover any deficiencies related to these areas at this department during the audit.

Legislative Action: Unknown.

Finding #2: Some courts appear to be inappropriately sentencing batterers to anger management programs that do not last 52 weeks and may not address domestic violence issues.

During the course of our audit, department officials told us, and evidence we found at one county we visited confirmed, that courts were directing individuals placed on probation for crimes of domestic violence to 16-week anger management programs, rather than the required 52-week batterer intervention programs. We also found one instance in Los Angeles County where the court delayed sentencing on an individual it found guilty of battery (the victim met the statutory definition of domestic violence contained in Family Code 6211) until 26 court-ordered program sessions could be completed. Then, after six months of delayed sentencing, it dismissed the charges "in the furtherance of justice."

We recommended that the courts consistently sentence, and the departments consistently direct, individuals granted probation for a crime of domestic violence—when the victim is a person specified in Section 6211 of the Family Code—to a 52-week batterer intervention program approved by the department. Courts should not substitute any other type of program, such as a 16-week anger management program, for a 52-week batterer intervention program.

If it is the Legislature's intent that individuals who commit domestic violence be consistently sentenced to 52 weeks of batterer intervention, it should consider enacting statutory provisions that would not allow the courts to delay sentencing so that batterers can complete a lesser number of program sessions.

Los Angeles County Probation Department's Action: None.

In its original and subsequent responses, the department in Los Angeles County provided no specific information from the court on this recommendation.

Riverside County Probation Department's Action: Corrective action taken.

The department in Riverside County indicated that the vast majority of domestic violence defendants are ordered into a 52-week batterer intervention program and that the court has attempted to correct any sentencing variation through training and ongoing communication. Additionally, the department stated that the court established countywide guidelines for sentencing all domestic violence clients, including the 52-week program requirement.

San Joaquin County Probation Department's Action: Partial corrective action taken.

The department in San Joaquin explained that, although it has requested otherwise, the court continues to give the department discretion on the type of treatment program batterers attend. However, the department has provided written guidance to its probation officers that, when making program referrals, they must consider the arresting offense and the nature of the relationship between the offender and the victim, not just the charge to which the batterer was convicted.

Legislative Action: Unknown.

Finding #3: County probation departments could improve their monitoring of programs by more closely adhering to state law and by implementing performance measures.

Although state law requires departments to design and implement a program approval process, we found that none of the five departments we visited had written procedures to guide staff in analyzing and approving applications or application renewals. Additionally, we found that two departments we visited could not provide documentation of their reviews of the applications they had approved in the last five years. However, the applications approved in the last five years that we were able to review generally conformed to statutory requirements.

State law requires the departments to conduct annual on-site reviews of their programs, including monitoring sessions, to determine whether they are adhering to statutory requirements. To ensure that the programs are complying with statutory requirements, the departments would also need to perform on site reviews of program administration, such as the use of sliding fee schedules to assess the program fees batterers pay. However, based on our interviews with staff at all 58 departments and our review of selected programs at five departments, on-site reviews are not performed consistently. For example, the five departments we visited skipped years and programs in their on-site review efforts. Among the examples of programs straying from state requirements, we found one program that used an unqualified facilitator to oversee counseling sessions that were not single gender, as called for by law, and sessions that sometimes consisted only of movies that were not even related to domestic violence.

Further, while some departments have implemented program-monitoring practices beyond those required by law, such as meeting regularly with program directors; implementing performance measures, such as tracking program completion percentages and batterer recidivism, could improve program effectiveness. Another untapped measure of program effectiveness is the systematic collection of feedback from program participants.

We recommended that each department adopt clear, written policies and procedures for approving and renewing the approval of programs, including a description of how department personnel will document reviews of program applications.

We also recommended that each department consistently perform the on-site reviews required by state law. Specifically, a department should annually perform at least one administrative review and at least one program session review for each program. Further, the departments should document their reviews, inform programs of the results in writing, and follow up on areas that require correction.

Finally, we recommended that each department consider developing and using program performance measures, such as program completion and recidivism rates, and developing a mechanism to receive feedback from batterers on program effectiveness.

Butte County Probation Department's Action: Corrective action taken.

The Butte department indicated that, in addition to developing a program application checklist and conducting comprehensive recertification reviews on its two programs, it has begun conducting biannual administrative reviews and quarterly program session visits. Further, the department stated that, although it faces information gaps because some batterers are court-supervised, it attempts to gather relevant statistical information from the programs on enrollments, successes, and program failures. The department commented that it is working on closing the information gaps to provide more relevant measures.

Los Angeles County Probation Department's Action: Corrective action taken.

The Los Angeles department indicated that, although it does not anticipate adding new programs, it has developed a checklist to review a program application should the need arise. In its original response to the audit, the Los Angeles department indicated that it conducts program site visits at least annually, and usually semiannually. These visits are to include sitting in on an actual program session and a review of a random sample of administrative files. The department stated that it considered the feasibility of conducting a customer service evaluation for batterers who complete a program but determined that it did not have the resources to undertake this process. The department also indicated in its original response to the audit that it is developing the means to track recidivism data for batterers on formal probation.

Riverside County Probation Department's Action: Corrective action taken.

The Riverside department indicates that it uses the penal code and a manual developed by the California Institute of Human Resources at Sonoma State University to approve and renew the approval of programs. The department stated that all of its programs now receive at least one administrative review and at least one program session review, as required. Finally, the Riverside department responded that it has considered a number of avenues for collecting relevant program statistics and is currently pursuing statistics from the program on the number of referrals and completions, as well as a client survey upon completion of the program.

San Joaquin County Probation Department's Action: Corrective action taken.

The San Joaquin department has developed written procedures for approving and renewing provider applications. The department indicates that it continues to conduct administrative and program session reviews as required. Finally, the department indicates that it has developed a system that allows program providers to submit information, such as enrollments, attendance, terminations, completions, and quarterly progress reports directly to the department in electronic format. The department stated that, in addition to creating "to do" action items for providers and probation officers, it will also allow the department to track outcome measures by individual provider.

San Mateo County Probation Department's Action: Partial corrective action taken.

To the recommendation regarding written policies and procedures for approving and renewing program applications, the San Mateo department responded, "This is our current practice," without providing any additional information indicating what it has done to correct the deficiencies we found when we visited the department. In regards to on-site program reviews, the department responded that it was not in compliance at the time of the audit but has now installed an annual review process as required. In regards to developing program measures, the department stated there are customer service forms available to all probationers and other members of the public.

Department of Corporations

It Needs Stronger Oversight of Its Operations and More Efficient Processing of License Applications and Complaints

REPORT NUMBER 2005-123, JANUARY 2007

Department of Corporations' response as of July 2007

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to review the operations of the Department of Corporations (Corporations) to ensure that it is effectively fulfilling its responsibilities. Generally speaking, we were asked to evaluate Corporations' progress toward meeting the goals and performance measures outlined in its strategic plan as well as its progress toward implementing any changes needed to fulfill its goals effectively. We were also asked to review Corporations' workload studies and fee analyses to determine the extent to which it has implemented any recommendations from these efforts. Furthermore, the audit committee requested that we evaluate Corporations' education and outreach efforts in achieving its goals.

We were also asked to evaluate Corporations' licensing policies and practices to determine if they are efficient, protect consumers, and prevent fraudulent applications from being processed. The audit committee requested that we review a sample of each type of license issued to determine whether the policies are applied consistently and to determine the length of time it takes to issue a license. It also asked that we assess Corporations' policies and practices related to the monitoring of licensees, including the number and frequency of licensee audits that are conducted and the effectiveness of the audits. Finally, we were asked to identify the number of complaints Corporations receives annually and to evaluate its policies and practices for handling complaints, including its process for monitoring the ongoing investigation of complaints, the types of enforcement actions taken, Corporations' ability to enforce actions taken as a result of complaints, and its criteria for deciding to reject a complaint or to turn it over to another enforcement agency.

Finding #1: The fees Corporations collects result in an inequitable distribution of charges among licensees and an excessive fund reserve.

Corporations, which does not receive support from the State's General Fund, supports its operations through revenues earned from fees charged for processing applications for notices, registration certificates, permits, and the initial issuance and renewal of licenses. We found that since 2001, Corporations has not analyzed the licensing and examination fees it charges businesses to determine whether the fees matched its costs of providing the related services. As a result, certain licensees are subsidizing costs for others because Corporations overcharges for some fees and undercharges for others. For example, revenues from securities fees have exceeded the related service costs for six of the last seven fiscal years. The amount of excess revenues from these fees ranged from $750,000 to $9.1 million and totaled $22.2 million during this time. By contrast, the service costs for nine other business activities Corporations regulates have exceeded

Audit Highlights . . .

Our review of the Department of Corporations (Corporations) revealed the following:

- *Corporations' current fee structure results in certain licensees subsidizing the administrative costs for others. For example, revenues from securities fees have exceeded the related service costs by $22.2 million over the last seven years.*
- *Corporations has taken important steps in strategic planning for its operations, however, these efforts are undercut by inaccurate statistical information about its actual performance as reported in its monthly and quarterly performance reports.*
- *Corporations does not always process applications within the time limits set by state law. In fact, for applications submitted between January 2004 and May 2006, the average processing time exceeded the time allowed by law for many of the application types we reviewed.*
- *Although there is no legal requirement dictating the length of time Corporations has to resolve complaints, we found examples of unnecessary delays in a sample of complaints we reviewed.*
- *Corporations has three primary information systems for capturing complaint related data; however, none of them are reliable for determining the number, type, and status of its complaints because the systems contain too many blank fields, duplicate records, and errors.*
- *Corporations did not conduct required examinations of at least 170 licensed escrow offices and 899 licensed finance lenders within its four-year goal.*

the revenues generated from their respective fees by $21 million over the last seven fiscal years. The overcharging of certain licensees has not only covered the undercharges for other services but has also contributed to the buildup of a large reserve in the State Corporations Fund. We anticipate that this reserve will exceed statutory limits at the end of the current fiscal year.

Fees for the licenses processed by Corporations are generally set by statute. Although Corporations has limited authority to set fees below the statutory maximum for businesses that deal with certain securities transactions, offer investment advice, or act as broker-dealers, the only way it can increase fees above the statutory cap is to seek a change in the law.

To strengthen its operational oversight, we recommended that Corporations seek legislative authority allowing it to set fees by regulation. This legislative authority should require that Corporations annually assess its fee rates and establish fees that are reasonably related to its cost of providing the services supported by its fees. Corporations should also factor in the amount of any excess reserves when conducting its annual assessment.

Corporations' Action: Partial corrective action taken.

Corporations submitted a placeholder bill, AB 1516, which would have allowed the commissioner to adjust fees to reflect the actual cost of regulatory services for each law and program. However, although the Legislature preferred to maintain the existing structure outlined in statute, Corporations plans to submit a proposal in January 2008 that will change the statute to provide the commissioner limited authority to adjust fees while maintaining legislative oversight.

Corporations currently has statutory authority to make the adjustments necessary to eliminate deficits in some programs and indicated it has done so to the extent possible. For those programs where there is a cap on the assessed fee that limits its ability to make adjustments, Corporations stated it has adjusted the fee to eliminate the deficit in two fiscal years. Corporations also stated it will annually review its other rates to determine if the fees are sufficient to support program activities. If the attempt to obtain limited authority to adjust fees is denied, Corporations will request a fee adjustment from the Legislature for programs that have fees set in statute and have a deficit or surplus. Finally, Corporations stated it would review and adjust the reimbursement rate for examinations performed.

Finding #2: Corporations has made a good start on its strategic planning but needs better information about its actual performance.

Corporations has taken important steps in strategic planning for its operations, establishing a framework to identify its strengths and weaknesses with the goal of eliminating inefficiencies and increasing productivity through an examination of its current policies and procedures. Corporations' efforts include creating three interrelated documents—a strategic plan, a program-level action plan, and periodic statistical performance reports—designed to establish its goals and measure its effectiveness in meeting those goals. However, the effectiveness of its strategic planning effort is undercut by inaccurate statistical information about its actual performance as well as by the cumbersome methods used to compile the information for the performance reports. We found errors in the manual compilation of three of the 10 performance measures we reviewed. For instance, Corporations reported that the percentage of other securities regulation applications actually processed on time was 96.5 percent, but we calculated it to be 89.5 percent. Although this relatively small difference might not change Corporations' assessment of the need for change in the area, it does illustrate the need for more accurate reporting.

Corporations' systems for collecting its actual performance information are also cause for concern, because of inefficiencies and the potential for errors. Depending on the performance measure, Corporations uses both manual and automated systems to collect the information, and it then manually compiles that information for summary in a performance report. An automated system, with all necessary information accurately reported, would be more efficient and reliable. Currently, the

information used to produce the reports comes from a variety of sources, such as forms, data system queries, spreadsheets maintained by team leaders, and other documents that may or may not be reviewed for accuracy. We found one instance in which staff used informal notes, rather than standard time sheets, to report the time worked on applications. Each month, certain Corporations' staff must generate statistics by performing time-consuming manual calculations and then must input the results into a separate form for the report.

To improve the efficiency and effectiveness of its system for collecting actual performance measure information, we recommended that Corporations do the following:

- Consider assessing the need for new automated data systems or determining whether its current systems are capable of collecting the necessary information.

- Ensure the accuracy and completeness of the information in its automated systems by requiring staff to enter the information and requiring supervisors to review it periodically. For data not currently available in automated format, Corporations should develop stronger procedures to ensure that staff accurately report and supervisors accurately review the information. Corporations should consider calculating and reporting performance measures quarterly, rather than monthly, until it has a more efficient data collection system.

- To ensure that it has identified all necessary performance measures and appropriately focused its current performance measures, Corporations should continue to assess the reasons for performance deficiencies and add or adjust performance measures as needed.

Corporations' Action: Partial corrective action taken.

Corporations indicated it has met with the Department of Finance (Finance) to discuss the process to obtain or update its automated data systems and has issued a Request for Proposal for a needs assessment and feasibility study. Corporations also expects a contractor to soon begin the needs assessment and prepare a feasibility study report and expects to submit the report to Finance by January 2008. According to Corporations, databases have already been created to capture significant dates in the application process and the initial use of the databases began in June 2007.

Corporations indicated it has implemented procedures that require staff to confirm the accuracy of information posted in its automated systems prior to exiting the system. Further, Corporations stated that under its new procedures managers or supervisors will review source documents on a sample basis and ensure that information on the source documents matches information in the electronic file. The procedures also direct managers and supervisors to review their automated systems monthly for blank fields and request that staff research and complete the data fields with the appropriate information. Further, Corporations indicated that managers will counsel and provide training to employees who consistently make errors when posting information to the automated systems.

Additionally, Corporations stated that it modified its procedures that allowed more than one complaint file to be created in the data system for the same complaint. Among other things, these procedures require a supervisor to review the listing of complaints for duplicate files. Additional procedures are also being developed for the review of other data related to complaints. Finally, under its modified procedures Corporations stated its legal counsel will perform a monthly review of the data fields in the Enforcement Case Management System to ensure that all fields are completed and any deficiencies will be discussed with the assigned counsel and the correct information will be posted in the system.

Corporations indicated that the Securities Regulation Division (securities division) has completed an initial review of performance measures to identify deficiencies and determine what caused the deficiencies and develop corrective action plans to meet performance measures. According to Corporations, the securities division will also re-evaluate performance measures, baselines and targets for appropriateness and accuracy. Managers will evaluate and report quarterly to executive staff performance deficiencies and their corrective action plans.

Corporations stated that the Financial Services Division (financial division) will review and monitor processing times and compare them with benchmarks on a quarterly basis. Further, the financial division will develop corrective measures to address any issues identified and develop new, more appropriate measures that are achievable.

Finding #3: The effectiveness of Corporations' outreach unit is uncertain.

Corporations does not collect enough data or identify sufficient goals to effectively assess its education and outreach efforts. One of Corporations' Education and Outreach Unit's (outreach unit) primary programs is its Seniors Against Investment Fraud (seniors program), which is designed to educate senior citizens about investment fraud and how to protect their finances from predatory schemes. In its budget change proposal for fiscal year 2005–06, Corporations requested $400,000 in ongoing permanent funding for the seniors program (and received $225,000). The proposal identified 12 performance measures intended to aid Corporations in evaluating the achievement of the objectives of the seniors program. However, Corporations does not collect data for four of these measures. For example, when it sought funding for the program in fiscal year 2005–06, Corporations stated that it planned to track the number of seniors program volunteers by geographical area; it had not done so as of December 2006. Corporations does not track any data for three other performance measures because, according to the director of the outreach unit, the measures are not clear. Further, although Corporations collects data for eight of the 12 performance measures, it measures its effectiveness for only two—the number of publications disseminated and the number of presentations given—by comparing them to established goals. However, without sufficient data and relevant benchmarks, it is impossible for Corporations to effectively assess its overall performance in protecting senior citizens from investment fraud.

Moreover, Corporations has not developed any formal goals to effectively measure the success of its other primary program—the Troops Against Predatory Scams Investor Education Project (troops program). The troops program was funded by a grant that requires that Corporations collect data and report the results on seven performance metrics. However, Corporations has not established any formal benchmarks to gauge whether or not its efforts were successful. As a result, Corporations cannot assess whether the program is achieving the desired results.

To ensure that the outreach unit can effectively measure its success, we recommended that Corporations should ensure that it collects all of the necessary data and establishes reasonable benchmarks.

Corporations' Action: Corrective action taken.

According to Corporations, in January 2007, the outreach unit developed a monthly reporting form that will capture the number of seniors program partners and training kits distributed. Corporations also stated that the outreach unit also revised existing performance measures and benchmarks based on relevancy and accuracy. The outreach unit eliminated six of the existing 12 performance measures and replaced them with four new performance measures. Data will be collected monthly and measured against the benchmarks.

Finding #4: Corporations does not always process applications within the time limits set by state law.

State law requires Corporations to assess the completeness of applications and notify applicants in writing of any deficiencies in the applications within specific time frames, and either issue or reject the application within a specified time period. We found that Corporations does not always process applications within the time limits set by state law. For example, of the 35 applications we reviewed, we noted 10 instances where Corporations did not comply with the statutory time frame for processing applications. Delays could result in entities being unable to conduct business. Delays may also increase the likelihood that businesses will conduct unlicensed financial transactions. However, while Corporations is responsible for the delays in processing some license applications, other factors outside of its control also contribute to lengthy processing times. For instance, license applicants do

not always provide the required information when submitting applications. Deficiencies in applications and delays in correcting them create additional work for Corporations' staff and can substantially delay the issuance of licenses. We found that Corporations issued deficiency notices for 32 (91 percent) of the 35 applications we reviewed. Although application requirements can be somewhat daunting, they did not appear to be overly complex. According to Corporations, these delays generally occurred because of a backlog resulting from a large increase in the number of applications submitted in recent years and some applications requiring a more extensive review.

In addition, Corporations does not have complete data for some of its license applications. We found that the application system data related to corporate securities and franchises contain omissions and inaccuracies, hampering Corporations' ability to compile accurate performance statistics.

To ensure that all applications are reviewed promptly and sufficiently, we recommended that Corporations do the following:

- Continue to monitor the progress of applications through the review and approval process to identify any that have stalled, and investigate the reason for the delay.
- Follow the law in notifying applicants once their applications are complete.
- Follow up with applicants that do not promptly respond to deficiency notices.
- Assess whether it needs additional staff to process applications.
- Maintain all necessary data in its information management systems so that it can effectively calculate the number of days it takes to process applications.

Corporations' Action: Partial corrective action taken.

Corporations stated that it reviewed its procedures for processing applications submitted to its securities division in order to streamline the process to focus on the most critical factors in an application. According to Corporations, this process, along with hiring a retired annuitant, has significantly reduced the backlog of applications pending review.

Additionally, Corporations stated that the financial division has revised its procedures for processing applications to include having staff notify supervisors when an application has stalled. The reason for any delays will be determined and corrective action taken. Managers will also review a log or aging schedule to determine if any applications have stalled. These revised procedures will be written and included in an applications procedures manual. Further, Corporations indicated that it has developed and will maintain the data necessary to calculate the number of days it takes to process applications.

According to Corporations, it has revised the letter it sends to applicants notifying them that their application has been approved. The revised letter will now include both a reference that the application is complete and has been approved. Corporations also stated that it has developed a tracking mechanism that notifies staff at established intervals that an applicant has not responded to a deficiency notice. In these instances Corporations stated that staff will prepare a follow-up letter notifying the applicant that Corporations will close the application if the requested information is not received by a given date. A second notice will be sent if the information is not received and, if no response is provided, Corporations will close the application.

Corporations indicated that it is in the process of identifying the average number of staff needed to handle its normal workload. Corporations will also review the log of outstanding applications to determine if it is necessary to redirect resources, if possible, to prevent a further buildup of applications. Additionally, Corporations stated it is developing an overall plan to determine if additional resources are needed in various program areas and, if so, will seek those additional resources in the budget process.

Finally, Corporations stated that it has developed policies and procedures for ensuring that all applications received are logged for date of receipt, date approved/license issued, and the number of days for completion. The policies and procedures also require documenting the reasons for any extraordinary issues that delay processing.

Finding #5: Corporations is working to improve its handling of complaints.

Either the securities division or the enforcement division typically handles complaints related to securities regulation. Of the 20 complaints related to securities regulation we reviewed that were closed between May 20, 2005, and July 18, 2006, nine were referred to the securities division. It took the securities division an average of 312 days, ranging from 55 to 531 days, to resolve these nine complaints. The remaining 11 complaints related to securities regulation were referred to the enforcement division and took an average of 170 days to resolve, ranging from 20 days to 383 days.

The time Corporations takes to resolve complaints is contingent on many factors. For instance, the complexity of the case, the availability of staff, and the time it takes for complainants to respond to Corporations' inquiries all may contribute to the length of the process. Moreover, there is no legal requirement dictating the length of time Corporations has to resolve complaints. Thus, we expected the number of days Corporations took to resolve securities regulation complaints to vary depending upon the circumstances of each case. Nonetheless, during our review, we identified four complaints in which unnecessary delays increased the length of the process. For example, the securities division did not begin its investigation of one complaint until 277 days after the complaint was received. In another instance, the enforcement division took 176 days to refer a complaint to the securities division for further action, during which time nothing was done to address the complainant's concerns. Corporations' management could not explain these delays.

Moreover, we reviewed a sample of 20 complaints related to financial services that were closed between November 29, 2004, and August 8, 2006. We found that Corporations took between 35 and 232 days to close these complaints, averaging 106 days. Unlike its process for handling complaints related to securities regulation, Corporations handles financial services complaints by sending letters to licensees requesting them to respond in writing to the complaint allegations within 15 days. Delays can occur if the licensee does not respond within the 15-day time frame. However, we found some instances in which unnecessary delays on Corporations' part increased the length of the process. For example, in four of the 20 complaints we reviewed, Corporations took between 34 and 210 days to send letters to the complainants notifying them that it had begun its review, exceeding its 30-day goal. In two of the four cases, Corporations' staff did not forward the complaints to its financial division for handling for 28 and 38 days, respectively. However, Corporations' staff forwarded the two remaining cases in less than six days.

Corporations has recently modified its procedure for handling complaints. In addition to developing formal policies for rejecting and referring complaints, it has centralized the intake of all complaints by forwarding them to a new complaint team. Corporations believes that this new process will allow it to respond immediately to complaints and prepare each complaint for referral to the appropriate division. Because Corporations initiated this process near the end of our fieldwork, we were unable to test whether it will correct any of the weaknesses we identified. However, it appears that the process contains good business practices.

To improve the efficiency of its complaint-handling process, we recommended Corporations do the following:

- Develop procedures to track the progress of complaints to ensure that they continue to move through the process without unnecessary delay.

- Monitor its newly established complaint-referral process and develop procedures, if necessary, to decrease the length of time it takes to refer cases to the appropriate division.

Corporations' Action: Corrective action taken.

Corporations stated it established a complaint team in August 2006 that revised the processing of complaints. As a result, Corporations stated that the time to respond to a complaint has been shortened. The complaint team also developed a monthly report that tracks the number of complaints received, the backlog of complaints, responses to complainants, and the average number of days it takes to process complaints. Additionally, Corporations stated that the enforcement division has developed plans and goals that involve completing case investigations and either taking action or closing a case, as appropriate.

Corporations stated it will continue to monitor its complaint-referral process to look for additional ways to decrease the timeframes for processing complaints. Additionally, an executive staff member will review the complaint-referral procedures and protocols and provide recommendations to the commissioner on how to improve the process.

Finding #6: Information systems containing data regarding complaints are unreliable.

Although it has three information systems for tracking complaint data, Corporations undercuts these efforts by failing to ensure that any of the three systems contain reliable data. Several of the critical data fields in Corporations' Customer Relationship Management (CRM) system and Corporations' Customer Service System (CSS) were often left blank, limiting the usefulness of these systems as management tools. For example, the fields needed to calculate complaint processing times, such as date received, date assigned, and date opened, were blank 9.5 percent, 25 percent, and 68 percent of the time, respectively, for the CRM system. Consequently, these fields cannot be used to determine where a complaint is in the resolution process or to monitor and evaluate complaint-processing times. In addition, we found that the field identifying the specific law a complaint was related to was left blank for more than 24 percent of the 2,876 complaint records in the CSS and for 50 percent of the 2,461 complaint records in the CRM system. Without this information, Corporations cannot determine how many complaints it receives about alleged violations of various laws and cannot effectively identify problem areas or adjust its workforce to handle them.

Moreover, we found several types of data entry errors in Corporations' complaint systems. For example, the CRM system did not reflect the correct status for many of the complaints we reviewed. The status field can be used to indicate the disposition of a particular case, such as closed, in progress, or referred. However, the CRM system listed an incorrect status for 13 of the 20 complaints we reviewed. In each of these cases, the CRM system indicated that the case was still in progress, even though all of them had been closed. Thus, Corporations cannot rely on the system to determine the number of complaints still in progress, completed, or referred to another division. We also found that the CRM system did not reflect the correct date received for eight of the 20 complaints we reviewed. Specifically, the date entered into the CRM system as the date received did not agree with the supporting documentation for four of these complaints, and it was left blank for the others. Similarly, we found data entry errors for the field intended to capture the date a complaint was received in three of the 20 complaints we reviewed in the CSS. In addition, six of the 34 enforcement actions we tested in the Enforcement Case Management System reflected an incorrect date for when the action occurred, limiting the usefulness of the system as a management tool.

To improve the usefulness of its information systems, we recommended that Corporations review its existing complaint records and eliminate duplicates and correct any inaccurate fields. Further, Corporations should maintain accurate and complete data to ensure that the information systems can be used more effectively as management tools.

Corporations' Action: Pending.

Corporations did not fully address our recommendations in its response. Specifically, it noted that the enforcement division is reviewing its case management system to determine how to improve it. Options include using more fields of data and creating reports that would capture data to assist management using trends and workload issues. However, its response did not directly address our recommendation to review its existing complaint records and eliminate duplicate records and correct any inaccurate fields.

Finding #7: Corporations failed to perform required examinations of some licensees.

Corporations did not conduct examinations of many of its escrow licensees within the time frames required by law. Additionally, Corporations did not conduct examinations of its licensed finance lenders as frequently as required by its internal policy. Consequently, Corporations' ability to protect consumers against potential fraudulent lending and financing scams was weakened.

The California Financial Code requires Corporations to conduct examinations of licensed escrow offices and mortgage lenders at least once every four years. In addition, although not required by law, Corporations has established a goal for examining every licensed finance lender at least once every four years. However, Corporations did not conduct examinations of many escrow offices and finance lenders within the last four years. Specifically, we found that at least 170 licensed escrow offices and 899 licensed finance lenders—representing 37 percent and 35 percent, respectively, of all such licensees that required examinations—have not had an examination for at least four years. Corporations was more effective with its examinations of mortgage lenders; only two licensed mortgage lenders—less than 2 percent—did not receive the required examination within at least the last four years.

Corporations also lacks clear guidance for conducting examinations and following up on the deficiencies it identifies. For example, it does not have any policies or procedures on the time frames within which examiners must follow up on licensees' responses to deficiencies identified during an examination. In a sample of 20 examinations performed by the financial division, Corporations' examiners identified a total of 112 deficiencies related to 17 of the examinations; the remaining three did not identify any deficiencies. The identified deficiencies included improper charges, unauthorized disbursements from accounts, and altered checks. When we followed up on six of the 17 examinations that identified deficiencies, we found that in four cases the examiners took between 79 days and 187 days to provide a response to the licensees after they had responded to the deficiencies. We expected Corporations to have established response time frames to ensure the prompt resolution of any deficiencies.

We recommended that Corporations develop a plan to conduct examinations of licensees in accordance with state law and its own internal policy. Corporations should also establish clear guidance and response time frames for following up on deficiencies identified in examinations.

Corporations' Action: Partial corrective action taken.

Corporations stated that it has identified the number of licensees that need to be examined based on statutory requirements or internal policy, as well as the average hours per exam. Additionally, Corporations received 30 additional examiner and enforcement positions in the fiscal year 2007–08 budget. Nevertheless, Corporations stated it will evaluate current staffing levels to determine whether sufficient staff exists to perform the required exams. If staffing levels are insufficient after staff redirections from other programs, Corporations stated it will pursue additional staffing through the budget process. Corporations also indicated that it developed procedures in September 2007 to review enforcement actions taken to determine compliance by licensees, to evaluate the enforcement action, and to identify high-risk candidates for follow-up non-routine examinations.

California Department of Corrections and Rehabilitation

It Needs to Improve Its Processes for Contracting and Paying Medical Service Providers as Well as for Complying With the Political Reform Act and Verifying the Credentials of Contract Medical Service Providers

REPORT NUMBER 2006-501, APRIL 2007

California Prison Health Care Receivership Corporation's[1] response as of November 2007

The state auditor has the authority to audit contracts involving the expenditure of public funds in excess of $10,000 entered into by public entities, at the request of the public entity. The court-appointed receiver requested that the Bureau of State Audits (bureau) conduct an audit of a variety of issues related to existing contracts between the California Department of Corrections and Rehabilitation (Corrections) and certain medical care providers. Specifically, the receiver requested that the bureau review Corrections' processes for procuring medical registry services and its practices involving these services for fiscal year 2005–06 and to determine whether the process is fair and adequate and complies with all applicable laws and regulations, whether the language used in medical registry contracts is adequate and complete and written in the best interests of the State, and whether conflicts of interest exist related to procuring the medical services.

Additionally, the bureau was asked to examine Corrections' medical registry contracts and payment practices for fiscal year 2005–06 and to determine whether contractors comply with the terms and conditions of the contracts, and whether Corrections' accounting and payment practices for contracts comply with laws, regulations, and industry practices. Finally, the bureau was directed to review the medical registry contracts and compare the rates Corrections pays contractors with the amounts the contractors pay their medical care providers, and to determine whether the contractors and medical care providers rendering services in the prisons meet all applicable licensing and certification requirements.

[1] In May 2005, four years after the Plata Davis (Plata) lawsuit was filed, and after meeting regularly with the parties to the Plata settlement, the court conducted hearings to determine if it was necessary to appoint an interim receiver. In February 2006 the court appointed a receiver. The court order making the appointment gave the receiver the authority to "provide leadership and executive management of Corrections' medical health care delivery system with the goal of restructuring day-to-day operations and developing, implementing, and validating a new, sustainable system that provides constitutionally adequate medical care to all members of the class action lawsuit as soon as practicable." To achieve those goals, the receiver has the duty to control, oversee, supervise, and direct all administrative, personnel, financial, contractual, legal, and other operational functions of Corrections' medical health care delivery system. In making these recommendations to Corrections, we understand that they would be implemented at the direction of the court-appointed receiver. We do, however, expect that if control and management of Corrections' medical health care delivery system is returned to it, that Corrections would then become responsible for implementing these recommendations.

Audit Highlights . . .

Our review of the California Department of Corrections and Rehabilitation's (Corrections) contracts for medical services revealed the following:

- *Corrections improperly awarded nine of 18 competitively bid contracts with a total maximum amount of more than $385 million.*
- *Corrections did not provide complete justifications for awarding two noncompetitively bid contracts totaling almost $80 million.*
- *Some aspects of Corrections' treatment of some medical providers raises concerns about whether they are, in fact, treated more as employees than independent contractors, which may expose the State to potential liability and penalties.*
- *Only 16 of the 21 contracts we reviewed contained terms that meet the standard of medical care called for in Corrections' regulations.*
- *Many of the contracts we reviewed did not contain terms that Corrections considers standard in medical service contracts to adequately protect the confidentiality, privacy, and handling of inmate medical records under the federal Health Insurance Portability and Accountability Act.*
- *Although all contracts in our sample gave Corrections the ability to inspect and monitor the quality of contractor performance, only five of the 21 contracts imposed a similar obligation on the medical care service providers.*

continued on next page . . .

- *Corrections overpaid registry contractors by $4,050 for five invoices because prisons did not consistently ensure that payment amounts agreed with contract terms.*
- *Corrections failed to ensure that prisons require their consultants to complete statements of economic interests or to document why it was appropriate for them not to do so.*
- *Corrections did not verify the credentials of providers who treat inmates outside of Corrections' facilities because it incorrectly believed these reviews were being conducted by the Department of Health Services.*
- *Of the 22 physicians and nurse practitioners for which we requested credentialing files, Corrections was only able to provide 12. Of these 12, eight were credentialed after they had begun providing services to inmate patients.*

Finding #1: Corrections did not always award contracts according to state policy or its own policy.

Corrections awarded nine of 18 competitively bid contracts incorrectly. Specifically, in awarding these nine contracts, Corrections assigned incorrect hierarchy positions to bidders, primarily because its practice was to apply the small business preference—a 5 percent preference given to small businesses bidding on state contracts—to the bidders' hourly rate rather than the bid price. As a result, for seven contracts Corrections failed to limit the preference to $50,000, as state law and regulations require, and for all nine contracts it gave bidders a larger preference than allowed, causing some bidders to incorrectly receive higher-ranking positions.

Corrections uses a cost threshold to limit the number of contract awards for its registry contracts but it does not have any written policies or procedures for determining the cost thresholds. Additionally, Corrections' solicitation documents did not inform the bidders of its use of a cost threshold or its methodology for calculating the threshold. Further, Corrections did not always apply the cost thresholds properly according to its stated methodology and, as a result, improperly awarded one contract and excluded another bidder from the opportunity to provide services. Finally, we found that Corrections did not always calculate the cost threshold using the methods it described to us and based on our calculations, it improperly awarded contracts. When Corrections does not apply the small business preference or its cost threshold properly, it may be unfairly preventing contractors from providing registry services or selecting contractors who do not meet its criteria.

We recommended that Corrections ensure that staff receive proper training on bidding methods, including the appropriate application of the small business preference, so that bidders are awarded contracts in the correct order. We also recommended that Corrections establish policies and procedures for determining the cost threshold used to limit the number of awards made to registry contractors and implement a quality control process to ensure staff calculate the cost threshold correctly and retain documentation to support their calculations in the contract files. Further, we recommended that Corrections notify potential bidders of its use of a cost threshold to determine the awards to be made and its methodology for calculating the threshold. Finally, we recommended that Corrections implement a quality control process to identify errors in the ranking of bidders before awarding contracts.

Corrections' Action: Partial corrective action taken.

According to the Office of the Receiver, it plans to change its process to ensure that the small business preferences are correctly applied. The Office of the Receiver also stated that it agrees that staff should receive additional training on bidding methods and its managers are currently providing informal training in the area of bidding and application of small business preferences. The Office of the Receiver plans to develop formal training materials by March 2008 and anticipates commencing formal training in April 2008.

The Office of the Receiver does not believe it is appropriate or feasible to establish policies and procedures regarding the methodology for determining the cost threshold used to limit the number of awards made to registry contractors. However, the Office of the Receiver stated that it will bring the issue to the attention of the consulting firm who will advise the Receiver regarding the organization of the Contracts Unit.

Regarding our recommendations to (1) implement a quality control process to ensure staff calculate the cost threshold correctly and retain documentation to support their calculations in the contract files and (2) notify potential bidders of its use of a cost threshold to determine the awards to be made and its methodology for calculating the threshold, the Office of the Receiver stated that it will take the recommendations into consideration when developing the policies and procedures. The Office of the Receiver anticipates completing the policies by March 2008 and commencing formal training for staff in April 2008.

Finally, the Office of the Receiver stated that it reissued a Request for Proposals in October 2007 to secure services of a consulting firm to advise on implementation of a quality control unit. The Office of the Receiver hopes to be in a position to evaluate and implement the consultant's recommendations by June 2008. In the interim, it developed a revised spreadsheet in July 2007 to rank bidders and there is also a pending upgrade to its software to perform this function automatically by March 2008.

Finding #2: Corrections' justifications for awarding two competitively bid contracts were incomplete.

State policy requires a minimum of three competitive bids except in certain circumstances. Corrections did not always retain complete justifications for awarding contracts when receiving fewer than three bids. Specifically, for two of 18 competitively bid contracts, Corrections did not receive three bids and did not justify the reasonableness of the award amounts. Also, although Corrections advertised these two contracts in the California State Contracts Register, it could not demonstrate that it solicited all known potential contractors as state policy requires. Consequently, Corrections was not exempt from complying with state policy requirements for awarding contracts with fewer than three bids.

We recommended that Corrections fully comply with state policy, including justifying and documenting the reasonableness of its contract costs, when it receives fewer than three bids. We also recommended that Corrections retain documentation of its efforts to solicit all known potential contractors when it advertises in the California State Contracts Register.

Corrections' Action: Partial corrective action taken.

According to the Office of the Receiver, it is setting appropriate rate structures for various disciplines in order to justify reimbursement and its process includes surveying state salaries and contract rates. Additionally, the Office of the Receiver stated that there is a system currently in place to document known providers. Finally, the Office of the Receiver stated that it will take these recommendations into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008.

Finding #3: Corrections could not justify the prices contained in two noncompetitively bid contracts.

Corrections did not retain justifications for the rates found in two of three noncompetitively bid contracts we reviewed. For one contract, with a maximum amount of almost $79 million, Corrections did not have documentation to support that the rates determined were fair and reasonable. For the second contract, with a maximum amount of $1 million, Corrections obtained approval from the Department of General Services (General Services) using a special category noncompetitively bid exemption request. However, Corrections was unable to produce documentation to support compliance with specific conditions of approval including following the price analysis and methodology

requirements of the special category exemption. When Corrections does not justify and document the reasonableness of the contract rates it agrees to pay, in accordance with the methodology approved by General Services, it is unable to demonstrate that the rates are appropriate and reasonable.

We recommended that Corrections fully comply with state policy including justifying and documenting the reasonableness of its contract costs when it chooses to follow a noncompetitive process. We also recommended that Corrections adhere to the price analysis and methodology approved by General Services when using the special category noncompetitively bid request process. For example, it should use Medicare rates as a benchmark for determining the reasonableness of its rates paid to contractors.

Corrections' Action: Pending.

According to the Office of the Receiver, it is setting appropriate rate structures for various disciplines in order to justify reimbursements and its process includes surveying state salaries and contract rates. The Office of the Receiver also stated that it will take this recommendation into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008.

According to the Office of the Receiver, although Medicare is not applicable to registry contracts, it has one report and is in the process of obtaining an additional report from a consultant to validate its transition to Medicare for non-registry contracts. The Office of the Receiver is also in the process of determining appropriate reimbursement structures for various services and its process includes surveying the community for similar service costs.

Finally, the Office of the Receiver stated that it will take this recommendation into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008.

Finding #4: Corrections paid some contractors for services provided before their contracts were approved by General Services.

For four contracts we reviewed, we noted seven instances, totaling almost $20,000, in which registry contractors were performing service at prisons before Corrections obtained General Services' final approval of the contracts. When Corrections does not ensure that it obtains proper approval before allowing contractors to perform services, it exposes the State to potential litigation if General Services does not approve the contract.

We recommended that Corrections ensure that it establishes internal control processes that prevent prisons from allowing contractors to perform services before receiving General Services' approval of the contract.

Corrections' Action: Pending.

The Office of the Receiver stated that it will take this recommendation into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008.

Finding #5: Some contracts did not contain Corrections' standard contract terms.

Three of 21 contracts in our sample did not contain terms that required Corrections to provide 24 hours notice to a medical registry if services had been scheduled but were not needed for a particular shift. Our legal counsel advised us that the reviewing court would likely find that reasonable notice would be an implied term of the contract. However, litigation can be averted if the parties define what constitutes reasonable notice in the contract.

We recommended that Corrections' medical registry contracts contain express provisions related to the required notice period for cancellation.

Corrections' Action: Pending.

The Office of the Receiver agrees with this recommendation and stated that by May 2008 it will ensure standard language pertaining to the cancellation of medical services is developed and included in new contracts.

Finding #6: Some contracts lack Business Associate Agreements that ensure compliance with federal requirements related to privacy, confidentiality, and transfer of inmate medical records.

Under the Health Insurance Portability and Accountability Act (HIPAA), Corrections may act as a covered entity in the provision of medical care to inmates and the various contractors with whom it does business may act as "business associates." As business associates, those contractors are obligated to follow HIPAA, which imposes various obligations related to the confidentiality and handling of prisoner medical information. HIPAA also requires that a business associate enter a Business Associate Agreement that imposes specific obligations designed to ensure compliance with HIPAA. Only six of 21 contracts we reviewed contained the required Business Associate Agreement.

We recommended that Corrections include Business Associate Agreements in all contracts subject to HIPAA and amend existing contracts to include those agreements.

Corrections' Action: Pending.

The Office of the Receiver agrees with this recommendation and stated that by May 2008 it will ensure standard language pertaining to the areas covered by HIPAA is developed and included in new contracts.

Finding #7: Corrections' treatment of its independent contractors raises concerns about whether they are, in fact, employees.

Although all the contracts in our sample contained terms that indicate medical registries act as independent contractors, we surveyed each of the contracting medical registries in our sample to evaluate their relationship with Corrections based on 20 general factors that the U.S. Department of the Treasury, Internal Revenue Service (IRS), uses to determine whether a worker is an employee or an independent contractor. Most of the contractors noted that they are not required to comply with specific instructions from Corrections on how to perform their services and half noted that they pay their workers directly, rather than having them paid by Corrections, which indicates a level of autonomy associated with that of an independent contractor. Other factors, however, suggest several areas in which Corrections appears to maintain a significant degree of control over the manner and means of performing the work. We noted that the IRS and the courts do not expressly state a single, definitive rule regarding what constitutes an independent contractor. Instead, the courts and the IRS make each decision based on the totality of the circumstances. As such, it is difficult to say whether medical registries would be deemed independent contractors or Corrections' employees.

Potential liability and penalties for misclassification of an employee include substantial taxes, back pay, and reimbursement of expenses. Furthermore, California does not make a distinction between intentional and unintentional misclassification of an employee. Thus, the responsibility for proper conduct and classification of an independent contractor falls upon the employer.

To ensure that there is no uncertainty surrounding the legal status of contract employees, we recommended that Corrections seek expert advice and legal counsel to determine whether its current treatment of certain medical registry service providers is such that those medical registry service providers should be considered employees rather than independent contractors.

Corrections' Action: Partial corrective action taken.

The Office of the Receiver stated that the issue as to whether or not registry employees are employees versus independent contractors is a statewide issue that will be referred to the State Personnel Board. This question has statewide implications and is beyond the scope of the Receiver.

The Office of the Receiver also stated that it is in the process of hiring full-time permanent civil service clinical staff, and there will be, over time, an elimination or significant reduction in Corrections' reliance on registries.

Finding #8: Contract terms related to the standard of care are inconsistent and sometimes ambiguous.

All 21 contracts in our sample contained terms related to the standard of care. However, only 16 contained terms that appear to meet the legally required standard contained in regulation. Even then, the language used to describe the standard of care in these 16 instances varies widely. Despite this variation, we considered all these terms to be essentially the same in that they appeared to call for the legally required standard of care set out in regulation. In four other contracts, the contracts contained terms that appear to have been drafted in an attempt to be consistent with the standard of care set out in regulation, but rather than requiring the contractor to meet that standard, they required the contractor to provide medical care "necessary to prevent death or permanent disability." According to our legal counsel, this language does not meet the minimum standard set out in regulation and appears to establish a potentially lower standard of care. In addition, one contract contained only a requirement that the contractor provide services consistent with scope of practice and did not prescribe a standard that was specific to a prison setting.

We also noted that many of the contracts in our sample contained multiple terms related to the standard of care within the same contract. In some cases, these terms appear to be inconsistent with one another. For example, 14 of 21 contracts contained terms requiring contracting medical care providers to follow the legally required standard in regulation and to follow generally accepted professional standards or national standards. We do not in any way question the value of following generally accepted professional standards or national standards. However, because it is not necessarily clear that Corrections' regulatory standard and the standard of care called for by professional or national standards are the same, this inconsistency may create an ethical dilemma and confusion on the part of medical care providers and may even result in litigation. We also noted a lack of consistency across our sample in terms of the standard of care being required. For example, only seven of 21 contracts required the contractors to meet national standards.

Finally, we found that some contracts contained terms related to the standard of care that were inconsistent with the American Medical Association's (AMA) recommendations. The AMA recommends that a contracting physician not obligate himself or herself to a standard of care that is higher than that required by law. Several contracts we reviewed called for the provider to meet Corrections' standard of care and called for "high quality" or even the "highest level of treatment within the scope of available resources" as the standard of care. Although we do not in any way question the importance of providing high-quality medical care to inmates, drafting contracts containing multiple terms that may suggest differing standards of care creates an ambiguity that may result in uncertainty on the part of the provider, and potential disagreement among the contracting parties, about just what is required under the contract.

We recommended that Corrections' medical registry contracts contain clear and consistent requirements related to the standard of care called for under the contract. At a minimum this standard of care must meet the standard of care needed in order to satisfy Corrections' obligations under the Plata settlement agreement. Also, to ensure that Corrections' contracts contain terms for standard of

care that meet its constitutional obligations as well as the standard of care that a practicing physician would provide if adhering to generally accepted ethical norms, Corrections should seek legal counsel and other expert advice to determine whether the standard of care currently prescribed in state regulations allows contracting physicians to provide medical care in a manner that is consistent with the generally accepted standard of care in the medical community. If the standard of care is not consistent with the generally accepted standard of care in the medical community, Corrections should revise its regulatory standard to require that the standard of care called for in the State's prisons is, at a minimum, consistent with medical ethics and with the State's constitutional obligations.

Corrections' Action: Partial corrective action taken.

According to the Office of the Receiver, it will ensure that Corrections' contracts include constitutional levels of care for prisoners, as the Receiver's mandate is to establish constitutional levels of medical care in California's prisons. However, the remainder of the recommendations that involve community standards of care may be more suitable for state consideration after the Receiver's work is completed and authority over Corrections' medical system is returned to the State.

Finding #9: Contract terms should impose clearer obligations for contractors to be insured against civil rights claims.

We found that all the contracts we reviewed called for the recommended level of liability coverage as specified by the State. However, although some of the contracts contained terms requiring the contractor to notify the insurance carrier that the contractor regularly provides services to inmates, it is not clear that this term necessarily would ensure that the contractor was insured against civil rights claims.

We recommended that Corrections require medical registries to submit proof that their insurance company has agreed explicitly to insure them against civil rights claims.

Corrections' Action: None.

According to the Office of the Receiver, no evidence has been provided that this recommendation is based upon specific cases of monetary loss. For example, no evidence has been submitted that the State has experienced losses due to civil rights violations by registry personnel. The Office of the Receiver states that while it agrees that a contract provision requiring an insurance company represent clinical registries concerning civil rights claims may seem desirable in theory, this requirement in practice is not one of the Receiver's top priorities for several reasons, including the following: (1) mandating such a clause may drive up the cost of registry contracts to a degree that is not fiscally justified; (2) private insurance carriers may not offer civil rights coverage because civil rights liability is, under certain circumstances, driven by "deliberate indifference" rather than negligence; and (3) given the existing unconstitutional conditions at many prisons, the insurance carrier may defend claims against registry staff by cross-complaining against the State because of the situation the registry clinician was placed. Therefore, we do not intend to implement this recommendation at this time.

Finding #10: Although many contracts require Corrections to inspect and monitor performance, few impose obligations on contractors to monitor or assess their quality of service.

All of the contracts in our sample enabled Corrections to inspect and monitor the quality of contractor performance. However, only five contracts imposed a corresponding obligation on the part of medical registries to monitor and assess the quality of their own performance.

We recommended that Corrections require registry contractors to monitor and assess the quality of services they provide under the contract.

Corrections' Action: None.

The Office of the Receiver stated that while it agrees that a contract provision requiring registries to monitor and assess the quality of their services may seem desirable in theory, in practice this requirement is not one of the Receiver's top priorities for several reasons, including the following: (1) mandating such a clause may drive up the cost of registry contracts to a degree that is not fiscally justified; (2) the monitoring and assessing of quality is a Receivership function and should not be delegated to private providers; and (3) there is no guarantee that the registry will perform this task adequately and therefore the Receiver will need to monitor the monitoring by the registry, which may be a fiscally unsound method of ensuring adequate clinical quality by registry staff. The Office of the Receiver also stated that it is in the process of hiring full-time permanent civil service clinical staff, and there will be, over time, an elimination or significant reduction in Corrections' reliance on registries.

Finding #11: Prisons did not always follow Corrections' procedures and contract terms for using registry contractors.

When prisons need to hire a service provider under a medical registry contract, Corrections requires them to follow the hierarchy outlined in the registries' contracts. For 22 of 38 invoices we reviewed that were subject to the hierarchy requirement, prisons did not provide us with sufficient documentation to demonstrate that they followed the hierarchy when obtaining services from registry contractors. When prisons do not consistently document their attempts to contact registry providers in accordance with the hierarchy, they expose the State to potential lawsuits from registry contractors for breach of contract terms and they hinder Corrections' ability to terminate registry contractors for nonperformance.

Also, we found that Corrections' policy allows prisons to send requests for services concurrently to all registries listed in the hierarchy. During our interviews with the 16 contractors in our sample, a few commented that, as a result of this practice, the providers do not respond to the contractors with the lowest bid but instead wait to be called by the contractors with the higher bids because they can receive more money.

We recommended that prison staff consistently follow procedures requiring them to document their efforts to obtain services from registry providers. We also recommended that Corrections reevaluate its policy of allowing prisons to send out service requests concurrently to all registry contractors listed in the hierarchy.

Corrections' Action: Pending.

According to the Office of the Receiver, it plans to take this recommendation into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008. Also, related to the recommendation that Corrections reevaluate its policy of allowing prisons to send out service requests concurrently to all registry contractors listed in the hierarchy, the Office of the Receiver stated that although services requests are solicited concurrently, the institutions are still required to follow the procedures developed to use the hierarchy. The Office of the Receiver also stated that it is in the process of modifying the hierarchy strategy, the number of registry contracts it has, and the actual reliance on the registry process.

Finding #12: Prisons sometimes fail to monitor invoices for medical services adequately.

Prisons could not provide sufficient evidence of their verifications that services were performed before they authorized payment for three of 50 invoices we reviewed. Prisons also did not always identify and adjust discrepancies between contract rates and providers' invoice charges resulting in overpayment of $4,050 for five invoices that totaled $458,346. In addition, prisons paid overtime on seven invoices even

though contractors did not adhere to the contract provisions for overtime. Further, prisons and regional accounting offices failed to take available discounts or took the wrong discounts for the wrong amounts in 14 instances, and paid contractors late penalty payments in four instances because they failed to pay the invoices in compliance with the California Prompt Payment Act (CPPA).

We recommended that Corrections ensure that prisons verify the services they receive from registry contractors before authorizing payment of invoices and continue to implement the draft of a departmentwide policy reiterating the need for prison medical staff to adhere to proper procedures for verifying registry contractors' hours before authorizing payment.

We also recommended that Corrections ensure that prisons obtain the necessary documentation for the services they were unable to verify or seek reimbursement from the registry contractors for the overpayments identified in this report and establish a quality control process to ensure that prisons pay rates that are consistent with contract terms.

Further, we recommended Corrections ensure that prison staff responsible for authorizing overtime adhere to overtime policies and contract terms. Corrections should also evaluate its prisons and regional accounting offices' processes for paying invoices and identify weaknesses that prevent it from maximizing the discounts taken and complying with the CPPA.

Corrections' Action: Pending.

According to the Office of the Receiver, it plans to take the recommendations into consideration when developing the policies and procedures. It anticipates completing policies by March 2008 and commencing formal training for staff in April 2008. Also, related to our recommendation that Corrections evaluate its prisons and regional accounting offices' processes for paying invoices and identify weaknesses that prevent it from maximizing the discounts taken and complying with the CPPA, the Office of the Receiver stated it agrees with the recommendation. Specifically, its new contracting and invoice processing system that is currently being piloted at four prisons will be centralized at headquarters commencing on October 18, 2007, and will help to improve or standardize the payment timeframes and maximize discounts taken. The Office of the Receiver's goal is to implement this processing system statewide incrementally adding prisons to the pilot program in a three-phased approach, which it anticipates completing by 2009.

Finding #13: Corrections fails to demonstrate that it complies fully with certain political reform act requirements.

Corrections lacks adequate controls to ensure that it complies with the duties and responsibilities outlined in the political reform act for filing officers. Specifically, Corrections could not demonstrate that all employees and consultants required to file statements of economic interests and seek approval before engaging in outside employment did so. We reviewed 124 statements and found that seven employees did not complete their statements correctly and 78 filed their statements late. Also, we found that 14 employees did not file statements at all. Further, seven of nine prisons did not submit a copy of the statements for their health care consultants or the chief executive officer's written determination that their consultants were not required to comply with disclosure requirements.

We recommended that Corrections establish an effective process for tracking whether its designated employees, including consultants, have filed their statements of economic interests timely. We also recommended that Corrections review the statements of economic interests to ensure their accurate completion and to identify potential conflicts of interests. Further, we recommended that Corrections ensure that the chief executive officer retains his or her written determinations for consultants.

Corrections' Action: Pending.

The Office of the Receiver agrees with the recommendation to establish an effective process for tracking whether its designated employees, including consultants, have filed their statements of economic interests timely and to review the statements of economic interests to ensure their accurate completion and to identify potential conflicts of interests. It plans to develop and implement a process by March 2008 for tracking and reviewing statements of economic interests.

The Office of the Receiver does not agree that registry consultants should be interpreted as "consultants" for purposes of annual conflict-of-interest disclosure purposes and plans to obtain a legal opinion by December 2007 regarding which government decision makers shall be required to submit Form 700 as outlined in the Political Reform Act. The Office of the Receiver stated that it will provide a copy of the legal opinion to the bureau.

Finding #14: Corrections' credentialing unit often failed to verify properly the credentials of registry contractors' providers.

The credentialing unit does not verify the status of all providers who treat inmate patients. Specifically, the credentialing unit does not perform database searches for providers who treat inmate patients outside of Corrections' facilities. The credentialing unit also does not perform database searches of providers who it classifies as allied health professionals, such as pharmacists, registered nurses, laboratory technicians, radiological technicians, dietitians, and physical therapists.

In addition, Corrections does not have a departmentwide policy directing the prisons to verify the credentials of these providers, which creates confusion and the risk that providers will not undergo any credentialing before performing services. The credentialing unit also does not perform database searches on all physicians and nurse practitioners who provide services to inmate patients. The credentialing unit performs a search only after the prisons submit a request.

Finally, the credentialing unit's database search method is inefficient. Specifically, providers' credentials are verified each time they move to another prison. According to Corrections' former credentialing coordinator, who is now the manager of the Plata Support Division's Pre-Employment Clearance Unit, based on information provided by the U.S. Department of Health and Human Services, she believed that because each prison has its own formal peer review process to further quality health care, federal law requires Corrections to register them as separate eligible entities for purposes of querying the databases. She also stated that Corrections' management has not formally adopted a written policy regarding her interpretation of federal law. This current process appears unnecessary and a waste of time and money.

We recommended that Corrections require the credentialing unit to verify the credentials of contracted providers who work in non-Corrections' facilities or, at a minimum, verify that these facilities have a rigorous process for verifying the credentials of their providers. Corrections should also establish a policy to define allied health professionals and to identify professionals who will be credentialed by the credentialing unit versus those credentialed by the prisons. We also recommended that Corrections require the credentialing unit to determine whether the credentials of those medical and allied health providers who are performing services at prisons under registry contracts have been verified. If not, the credentialing unit should verify them. Further, we recommended that Corrections ensure that prisons request National Practitioners Data Bank searches from the credentialing unit before allowing providers to perform services. Finally, we recommended that Corrections seek clarification from the U.S. Department of Health and Human Services regarding the criteria for eligible entities and whether or not all prisons can be combined into one eligible entity.

Corrections' Action: Partial corrective action taken.

According to the Office of the Receiver, it agrees with the recommendations and on August 30, 2007, it disseminated a contract provider policy that outlines the policy and procedure regarding what is required to credential contract providers that provide on-site services.

Additionally, related to the recommendation to require the credentialing unit to verify the credentials of contracted providers who work in non-Corrections facilities or, at a minimum, verify that these facilities have a rigorous process for verifying the credentials of their providers, the Office of the Receiver stated that the credential unit is in the process of determining the feasibility and processes as to the credential verification of outside community independent providers. Specifically, the credential unit is in the initial phase of developing policy to address the process in which all independent contractors who provide services outside of Correction's prison facilities either be credentialed through the Correction's Credentialing and Privileging Unit, or at minimum the contractor must have verified staff privileges at a JACHO (Joint Commission on Accreditation of Healthcare Organizations) accredited community hospital. The Office of the Receiver anticipates implementing this policy and procedure in March 2008.

The Office of the Receiver further stated that it agreed with the recommendation to establish a policy to define allied health professionals and to identify professionals who will be credentialed by the credentialing unit versus those credentialed by the prisons. The Office of the Receiver stated that the problem will be procedurally addressed with the development and dissemination of an Allied Health Professional certification checklist and protocols in conjunction with the credential policy and with the inclusion of requirements for certification and professional credentialing verification in contract language. Further, the new contract provider policy instructs the Health Care Management and Institutional Personnel Officers that they shall not hire any licensed independent provider until a credential verification has been completed and approved by the headquarters' Credentialing and Privileging Unit. Finally, related to the recommendation that Corrections ensure that prisons request National Practitioners Data Bank searches from the credentialing unit before allowing providers to perform services, the Office of the Receiver stated that it will develop and establish a statewide medical staff and peer review structure. Once this structure is in place, the 33 National Practitioners Data Bank entities will be deactivated and all providers will be processed through the main National Practitioners Data Bank entity. The Office of the Receiver anticipates this structure will be implemented by February 2008.

Department of Corrections and Rehabilitation

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

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

Department of Corrections and Rehabilitation's response as of March 2007

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.

Two of the nine exempt employees we reported on are no longer working at the center. We conducted additional analysis on the remaining seven employees for the time period from June 2005 to December 2006. We determined that exempt employees continued to earn holiday credits when a holiday fell on their regularly scheduled day off, resulting in an additional accrual of 268 hours and an additional gift of public funds of $8,909 for seven employees.

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.

Investigative Highlights . . .

The 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.*

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, between July 2002 and May 2005 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: Partial corrective action taken.

We conducted additional analysis on seven employees at the center for the time period from June 2005 to December 2006. The center continues to allow the employees to work alternate work schedules consisting of 10-hour days, but still requires them to charge leave only in eight-hour, six-hour, and four-hour increments, for employees working full-time, three-quarter time, and half-time schedules. As a result of this practice, the State paid these employees $21,161 for 620 hours they did not work.

In January 2007 the State and the union representing the employees in this case adopted a new collective bargaining agreement. This agreement specifies that exempt employees shall not be charged leave in less than whole-day increments.

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

Investigative Highlight . . .

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

Victim Compensation and Government Claims Board and Department of Corrections and Rehabilitation's responses as of February 2007

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: Corrective action taken.

The Board reported that it believes it had jurisdiction to hear the physician's claims and stated it did so under state law that allows the Board to hear claims when no statute or constitutional provision provides for the 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 the statutory relief was available in this case.

The Board also reported that it has changed its procedures to avoid making overpayments in the future. Specifically, the Board reported that it will not assume authority over claims in those instances in which it is aware that another agency is addressing the claim. Additionally, the Board reported that it changed its payment process for approved claims to ensure affected state agencies are aware of its actions.

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 April 2006 Corrections reported it had recovered $2,000 from the physician. However, it has been unable to confirm any additional amount the physician has reimbursed the State.

Nonprofit Hospitals

Inconsistent Data Obscure the Economic Value of Their Benefit to Communities, and the Franchise Tax Board Could More Closely Monitor Their Tax-Exempt Status

REPORT NUMBER 2007-107, DECEMBER 2007

Board of Equalization's, Franchise Tax Board's, and Office of Statewide Health Planning and Development's responses as of December 2007

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits to conduct an audit to ascertain whether the activities performed by hospitals that are exempt from paying taxes because of their nonprofit status truly qualify as allowable activities consistent with their exempt purpose. Specifically, the audit committee requested that we determine the roles of the entities involved in determining tax exemptions and the extent of oversight they exercise over nonprofit hospitals to ensure that they comply with requirements for tax exemption and community benefit reporting. It also asked us to examine the financial reports and any community benefit documents prepared during the last five years by a sample of both nonprofit hospitals and hospitals that operate on a for-profit basis and determine the value and type of community benefits and uncompensated care provided. In addition, the audit committee asked us to compare the community benefits provided by nonprofit and for-profit hospitals, and compare the types of care that both types of hospitals provide without receiving compensation (uncompensated care). Further, the audit committee asked us to review the financial information and the claims submitted to the State Board of Equalization (Equalization) or other agencies by nonprofit hospitals to determine whether they meet income requirements to qualify for tax-exempt status and to assess how tax-exempt nonprofit hospitals use excess income, to ensure that the uses are permissible and reasonable in terms of expansion of plant and facilities, additions to operating reserve, and the timing of debt retirement. The audit committee also asked us to determine the most current estimated total annual value of the taxation exemptions of both state corporation income taxes (income taxes) and local property taxes for nonprofit hospitals.

Finally, the audit committee asked us to determine whether the community benefits and uncompensated care provided by nonprofit hospitals meet the requirements for exemption from local property and state income tax. However, although state law outlines the requirements a nonprofit hospital must meet to receive an exemption from paying taxes, it does not specify community benefits and uncompensated-care costs as requirements. Additionally, although state law requires most tax-exempt hospitals to annually submit to the Office of Statewide Health Planning and Development (Health Planning) a community benefits plan (plan), which may include an uncompensated-care element, the law also clearly states that the information included in the plan a nonprofit hospital submits cannot be used to justify its tax-exempt status.

Audit Highlights . . .

Our review of tax-exempt hospitals revealed the following:

- *About 223 of California's 344 hospitals are eligible for income and property tax exemptions because they are organized and operated for nonprofit purposes.*
- *Comparing financial data reported by nonprofit and for-profit hospitals indicated the uncompensated care provided by the two types of hospitals was not significantly different.*
- *Benefits provided to the community, which only nonprofit hospitals are required to report, differentiate nonprofit hospitals from for-profit hospitals, but the categories of services and the associated economic value are not consistently reported among nonprofit hospitals.*
- *The values of tax-exempt buildings and contents owned by nonprofit hospitals are frequently misreported by county assessors.*
- *Lacking more reliable data, we used the reported economic values of community benefits and tax-exempt property to estimate that reported community benefits of $656 million for 2005 were roughly 2.7 times the estimated $242 million in state corporation income taxes and property taxes not collected from nonprofit hospitals.*
- *The Franchise Tax Board, which administers state income tax exemptions, could better use available tools, such as annual filings and audits, to monitor the continuing eligibility of nonprofit hospitals for their tax exemption.*

Finding #1: Lack of specific guidance regarding the content of community benefit plans precludes any meaningful comparison of the plans.

Although state law requires that tax-exempt hospitals submit plans to Health Planning, it does not require Health Planning to review the plans to ensure that hospitals report the same types of data consistently, nor does Health Planning do so. Further, the law provides only limited guidance regarding the content of the plan and does not mandate a uniform reporting standard. Thus, in reviewing the plans that eight tax-exempt hospitals submitted from 2002 through 2006, we found significant variations in the plans that precluded us from performing any meaningful comparison of the economic values the hospitals reported. Although the guidance provided in the law does not require uniform reporting, two hospital associations offer hospitals some guidelines. Additionally, the Internal Revenue Services (IRS) is proposing a new schedule for hospitals to prepare to be included with the informational return that all income-tax-exempt organizations must file. If adopted, the IRS anticipates using the new schedule for the 2008 tax year. The new schedule will require tax-exempt hospitals to report their community benefits and uncompensated-care costs and could influence hospitals to pattern their plans after the schedule's methodologies and format.

We recommended that if the Legislature expects plans to contain comparable and consistent data, it consider enacting statutory requirements that prescribe a mandatory format and methodology for tax-exempt nonprofit hospitals to follow when presenting community benefits in their plans. We also recommended that if the Legislature intends that the exemptions from income and property taxes granted to nonprofit hospitals should be based on hospitals providing a certain level of community benefits, it consider amending state law to include such requirements.

Legislative Action: Unknown.

Finding #2: Errors in reported property values reduce the reliability of estimated property taxes not paid by tax-exempt hospitals.

We attempted to estimate the amount of property taxes not collected from tax-exempt hospitals, using the values of the buildings and contents owned by tax-exempt hospitals that county assessors submitted on statistical reports to Equalization. Although we found numerous errors in the values that prevented us from ensuring the reliability of our calculation, this methodology resulted in an estimated $184 million in uncollected property taxes in 2005. More specifically, we found errors in the reported values for four of the 12 hospitals we reviewed, representing a total error of about $204 million. The errors for the remaining 211 nonprofit hospitals in the State that are eligible for tax exemption are unknown. Equalization performs surveys of county assessors to determine the adequacy of the procedures and practices they apply in valuing property for the purpose of taxation and for administering property tax exemptions.

To ensure that it provides accurate information regarding the value that is tax exempt, we recommended that Equalization consider including in its surveys of the county tax assessors a process for verifying the accuracy of the values reported on the annual statistical reports submitted by the county assessors.

Equalization's Action: Pending.

Equalization indicated in its response to the audit report that it plans to incorporate steps in its survey review of county tax assessors to verify proper classification of exempted property based upon the type of organization within the welfare exemption. It also stated that this will provide more accurate reporting of exempted values by hospitals.

Finding #3: Recent legislation affects the Franchise Tax Board's responsibilities for granting income tax exemptions.

We found minor weaknesses in the process the Franchise Tax Board (tax board) used in the past to determine the eligibility of nonprofit hospitals for state income tax exemptions. However, legislation effective January 1, 2008, will allow the tax board to rely on the federal income tax exemptions determined by the IRS. Although it was unable to obtain IRS reports and other information on the federal review process and thus could not gain a full understanding of the method the IRS uses to determine eligibility for tax exemptions, the tax board contended that its research of the IRS web site, publications, and tax law enabled it to conclude that the IRS process is sufficient to ensure proper determination of state exemption status. The tax board also stated that because state and federal laws on tax exemption are essentially identical, the additional audits it plans to perform—made possible by the workload reduction resulting from its use of IRS eligibility determinations—will compensate for any differences in quality between the state and federal review processes. The tax board indicated, however, that until it identifies the actual savings in workload that may occur when the new law is implemented, it cannot evaluate the opportunities for performing audits of nonprofit hospitals or plan for the number or frequency of such audits.

We recommended that, after it identifies the staff resources that are no longer required for reviewing tax exemption applications, the tax board implement its plan to use those resources for performing audits of tax-exempt entities, including hospitals.

Tax Board's Action: Pending.

The tax board stated that it will focus on increased compliance audits, as resources are available.

Finding #4: The tax board has limited assurance that nonprofit hospitals remain eligible for state income tax exemptions.

The tax board does not use the tools available to it, such as annual filings and audits, to monitor the continuing eligibility of nonprofit hospitals for income tax exemption. According to management staff at the tax board, annual filings, which contain information such as financial data and changes in business activities, offer the tax board's Exempt Organizations Unit (unit) a useful tool for reviewing ongoing compliance with the requirements for maintaining tax-exempt status. However, the unit does not review the information in the annual filings. Management at the tax board stated that the large volume of initial applications for income tax exemptions and limited personnel prevent unit staff from reviewing the annual filings. In the absence of monitoring by the tax board, hospitals exempt from income taxes sometimes submit annual filings that do not contain all the information required by the form or its instructions or information required under the California Code of Regulations (regulations).

Regular auditing is another tool the tax board could use to monitor the tax-exempt status of nonprofit hospitals. However, the tax board does not regularly conduct audits of tax-exempt hospitals, even though, based on data provided by the tax board, the revenues of these hospitals represent 17 percent of the total revenue of all tax-exempt organizations. According to the tax board, an audit can originate when members of the public express concern that a tax-exempt organization may be functioning in a manner requiring revocation of its tax-exempt status. The tax board indicated, however, that it could not identify any complaints that might have prompted audits of tax-exempt hospitals, because it does not maintain a central record of the receipt or disposition of those complaints. Rather, complaints against tax-exempt organizations are stored in the tax board's files and cannot be easily retrieved.

The tax board stated that the revenue information from annual filings entered into its automated record-keeping system could be used to identify income-tax-exempt nonprofit hospitals to be considered for audit. However, because the tax board has not ensured that all tax-exempt nonprofit hospitals are distinctly identified in its electronic data system, it is unable to efficiently generate

a list of the hospitals that might require audits. According to the tax board, creating such a list would necessitate manually reviewing the hard-copy files of the approximately 72,000 tax-exempt organizations operating in the State to determine which are tax-exempt hospitals.

Finally, the tax board told us that the IRS expects to perform an audit within three to five years after each organization receives a federal tax exemption, and it would notify the tax board of any revocations. However, the tax board does not currently coordinate with the IRS to identify audits of California tax-exempt hospitals in a manner that would allow the tax board to adequately rely on IRS audits for assurance of continuing eligibility.

We recommended that the tax board consider developing methodologies to monitor nonprofit hospitals' continuing eligibility for income tax exemption. These methodologies should include the following activities:

- Review the financial and other information from the annual filing submitted by hospitals exempt from income taxes.
- Ensure that the annual filing contains all the information the tax board's regulations specify as necessary for determining eligibility for an income tax exemption.
- Track complaints in a manner that enable the tax board to identify potential trends in noncompliance by income-tax-exempt hospitals and initiate audits of those hospitals.
- Adequately identify tax-exempt hospitals in its automated database, enabling it to use the information in the database to profile those hospitals and identify any potential noncompliance with the law.

The tax board should also gain an understanding of the frequency and depth of IRS audits of tax-exempt hospitals to identify the extent to which it can rely on IRS audits and factor that reliance into its monitoring efforts.

Tax Board's Action: Pending.

The tax board indicated that it plans to begin to develop an audit program to review the annual filings for hospitals to gain a better understanding of the compliance issues and materiality thresholds for ongoing reviews. It also stated that it has already implemented a new procedure to log all complaints into a computer database that documents the organization name, type, issue, and action taken. Additionally, the tax board indicated that as resources are available, it will begin updating the codes to separately identify tax-exempt hospitals from other types of charitable organizations. Finally, it stated that it is currently finalizing a memorandum of understanding (MOU) with the IRS that will allow the tax board to receive additional information on tax-exempt organizations. In addition to notification of final IRS actions authorized under the existing MOU, the new agreement will entitle FTB to receive information on proposed denials, revocations, and audit adjustments and names or organizations that have applied for federal exemption.

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 June 2007

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.

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

[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.

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.*
- *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.*

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 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

[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.

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: Corrective action taken.

Equalization reported that its new calculation of cigarette tax evasion resulted in an estimated $182 million of lost excise taxes per year, which is a decrease of $88 million per year from its previous estimate. Equalization stated that its use of an updated econometric model allowed it to use more recent data and consider the estimated combined effects of the implementation of the act and the new cigarette tax stamp.

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 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 2007

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.

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.*

[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: Partial corrective action taken.

Fish and Game reported that in August 2006 it began the process of adjusting rental rates to fair market values in accordance with DPA regulations and applicable collective bargaining agreements and began raising rental rates in October 2006. Fish and Game also reported that it last obtained appraisals approximately 14 years ago and in order for it to report accurate taxable fringe benefit information, it must first obtain current fair market appraisals for its properties. Fish and Game added that it has identified funding to obtain fair market appraisals and will do so after DPA establishes the master agreement for appraisers.

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.[2]

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.

[2] 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. Parks and Recreation has not reported any updated information since March 2006.

Department of Corrections and Rehabilitation's Action: Pending.

The Department of Corrections and Rehabilitation (Corrections), including the Division of Juvenile Justice, reported that DPA is anticipating awarding a contract for state-owned housing appraisal services that can be used by all state agencies. Corrections stated that it intends to obtain fair market appraisals for its properties through the contract, which is expected to be awarded by April 2007.

Department of Developmental Services' Action: Pending.

The Department of Developmental Services (Developmental Services) reported that it will obtain fair market appraisals once DPA establishes a master agreement of licensed appraisers and has authorized departments to begin contracting for appraisals. Developmental Services also reported that it has evaluated its systems and processes for reporting fringe benefits to ensure it will be in compliance with reporting guidelines once it is able to establish and update its rental rates.

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. Forestry has not reported any updated information since March 2006.

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

The Department of Mental Health reported that it updated its special order addressing employee housing in December 2006. This special order requires all four of its hospitals to perform appraisals of fair market rental rates for their properties by March 2007 and to reassess those rates annually. In addition, the special order requires its hospitals to report accurate taxable fringe benefit information in a timely manner.

Department of Transportation's Action: Corrective action taken.

The Department of Transportation (Caltrans) reported that it performed additional analysis to determine what amount of taxable fringe benefits it should have reported for 2003. It determined that the net total of additional income that should have been reported was $1,232 for six of its employees residing in state homes. Caltrans added that as of April 2006, this amount was reported to the tax authorities.

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 reported that it has adjusted rental rates for its properties 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.

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. Conservation has not reported any updated information since March 2006.

Department of Personnel Administration's Action: Pending.

The Department of Personnel Administration (DPA) reported that it became aware that some departments, which attempted to contract for appraisal services, received bids that were too costly and not in the best interest of the State. As a result, in February 2007 DPA issued a request for proposal in an effort to solicit bids for a statewide master agreement of licensed appraisers. DPA expects to finalize agreements in June 2007 with the seven appraisal firms awarded contracts.

Department of Forestry and Fire Protection

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

INVESTIGATION I2006-0663 (REPORT I2006-2), SEPTEMBER 2006

Department of Forestry and Fire Protection's response as of August 2007

We investigated and substantiated an allegation that Employee A, an employee of the Department of Forestry and Fire Protection (Forestry) submitted false time sheets and took time off without charging his leave balances.

Investigative Highlights . . .

An employee with the Department of Forestry and Fire Protection:

» ***Submitted false claims to receive $17,904 in wages for 672 hours he did not work.***

» ***Submitted a majority of his false claims to a supervisor with little or no knowledge of his actual attendance.***

Finding #1: Employee A fraudulently claimed hours he did not work.

Between January 2004 and December 2005, Employee A improperly claimed and received $17,904 in wages for 672 hours he did not work. He submitted nine false claims over this two-year period. Because these false claims were submitted on numerous occasions over a significant period of time and under a variety of different circumstances, we believe it is reasonable to infer that this individual acted intentionally when submitting these false claims. Employee A's supervisor told us that having accurate staffing information is critical, and that he reviews daily staffing reports each morning to ensure that he has sufficient staff to respond to emergencies. We found numerous instances in which Employee A's time sheets conflicted with these reports.

For example, Employee A received $9,884 by claiming he worked 372 hours when he was not present at work. During these hours, Employee B reported working to provide vacation coverage for Employee A. When questioned, Employee B stated that he worked all the hours he indicated for the purpose of covering for Employee A's vacation and that Employee A was not present during those hours. Furthermore, staffing reports confirm that Employee B was present for work and that Employee A was not.

Conversely, we identified 108 hours for which Employee A claimed he was providing vacation coverage for Employee B, even though Employee B's time sheet indicates he did not take leave and was at work during all these hours. Staffing reports confirm that Employee B was present for work and that Employee A was not present. When asked about these hours, Employee B asserted he did not charge his vacation balances because he was at work. He added that he did not know why Employee A claimed to work these hours because Employee A was not present during any of the hours claimed. Employee A received $2,906 for claiming these hours.

Finally, Employee A claimed to work 192 hours for which he received $5,114, but staffing reports indicate Employee A was not present during this time. Neither Employee A's nor Employee B's time sheet indicates that Employee A was providing vacation coverage during these hours. Employee A claimed that he worked his regular work schedule on his time sheet, but staffing reports indicate that he was not at work during any of these hours.

Forestry's Action: Pending.

Forestry requested to review our work papers in August 2006 to pursue corrective action. In addition, Forestry reported in March 2007 that it agreed that Employee A collected wages to which he was not entitled and had conducted its own investigation. Forestry also reported that it was assessing the adequacy of the documentation of its investigation and planned to recover overpayments and determine disciplinary action once the assessment was complete.

Forestry had not provided any other update as of August 2007.

Finding #2: The employee took advantage of poor supervision and weak controls to receive payments for hours not worked.

By claiming wages for hours he did not work, Employee A took advantage of his supervisor's lack of effective oversight and communication among the various staff with the authority to sign time sheets. Simply comparing Employee A's time sheets and daily staffing reports with those of Employee B would have shown that Employee A was submitting inaccurate time sheets. Although we acknowledge that efficient and effective firefighting is one of Forestry's critical responsibilities, responding to emergency situations does not relieve Forestry of its responsibility to maintain adequate payroll controls or to keep complete and accurate attendance records, as required by state law.

The supervisor acknowledged that he had not been as diligent in verifying the authorization and hours worked for his employees as he should have been and when one employee claimed he was providing vacation coverage for the other, he did not always compare time sheets for both employees when approving them for payment.

The supervisor also pointed out that other supervisors may approve these time sheets. Because employees and supervisors may work in the field or at headquarters at any given time, Forestry's practice is to allow individuals other than an employee's direct supervisor to sign time sheets. Up to nine people have the authority to approve Employee A's and Employee B's time sheets. As a result, it is possible that the direct supervisor may sign one, both, or neither Employee A's or Employee B's time sheets for that month. Four individuals other than his direct supervisor signed a total of eight of Employee A's time sheets for the two-year period we reviewed. We believe Employee A was able to claim wages for hours not worked without being detected because he took advantage of a lack of oversight and communication among those with the authority to sign his time sheets. Additionally, it appears Employee A may have exploited this relaxed management practice by frequently having supervisors other than his direct supervisor sign his time sheets when he claimed hours he did not work.

For example, a battalion chief who rarely works in the field approved 240 of the 672 hours Employee A improperly claimed. With multiple approving authorities available, Employee A had the opportunity to have his time sheets approved by someone who, at best, would have limited firsthand knowledge of the hours he claimed. Most of the false claims Employee A submitted were signed by someone other than his direct supervisor.

Forestry's Action: Partial corrective action taken.

Forestry issued a memo on December 1, 2006, to all stations in the unit in which the employee worked, outlining several steps intended to address the findings in the investigative report.

Supervisors with direct supervisory responsibility over a given employee are the only supervisors authorized to sign time reports for that employee. Program managers will compare each employee's work time with the appropriate daily staffing report. Employee's requesting time off that is not part of their annual vacation request process will be required to forward their request to a Division Chief or Duty Chief for approval per the "Master Schedule" for the unit. The memo includes a reminder to Battalion Chiefs to ensure that station log books, which are legal documents used to record and verify personnel transactions at the station level, are complete, accurate, and secure.

Management will also have the ability to access the department's personnel database to review staffing and personnel transactions, as well as recorded phone lines and radio transmissions to review conversations related to staffing and personnel decisions.

Finally, the memo reminds recipients that Battalion Chiefs will have the primary oversight responsibility for all personnel in their Battalions, and that Division Chiefs will conduct audits to ensure that all policies and procedures are followed and report their findings to the Unit Chief.

Forestry did not provide any other updates as of August 2007.

Department of Forestry and Fire Protection

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

INVESTIGATIONS I2005-0810, I2005-0874, AND I2005-0929 (REPORT I2006-1), MARCH 2006

Department of Forestry and Fire Protection's response as of February 2007

Investigative Highlights . . .

- *A Department of Forestry and Fire Protection (Forestry) supervisor approved improper overtime resulting in payments totaling more than $58,000.*
- *A Forestry employee took advantage of a lack of oversight and improperly received $3,445 for time he did not work.*

We investigated and substantiated an allegation that several Department of Forestry and Fire Protection (Forestry) employees improperly received overtime payments.

Finding #1: A Forestry supervisor authorized improper overtime for his employees.

The State's collective bargaining agreement with the firefighters' union provides for around-the-clock compensation when certain employees are assigned to a fire, but does not include air operations officers among those eligible for this type of compensation. Rather, air operations officers should be compensated only for actual hours worked instead of the duration of a fire incident. Further, department policy limits the number of work hours per day that its pilots are able to work to 14 hours. Because the air operations officers' reported overtime hours involved pilot coverage, these employees were subject to Forestry's 14-hour workday for pilots.

From January 2003 through July 2005, five air operations officers working as pilots received more than $58,000 for 1,063 overtime hours charged in violation of either department policy or their union agreement. In addition, two air operations officers working in maintenance received nearly $3,890 for overtime hours that it is not clear they actually worked. Specifically, we found that one air operations officer working in maintenance claimed five consecutive 24-hour workdays and the other maintenance officer claimed three consecutive 24-hour workdays, resulting in 80 total hours of overtime.

The supervisor of the air operations officers indicated that he mistakenly believed they were all entitled to around-the-clock pay when assigned to a fire.

Forestry's Action: Partial corrective action taken.

Forestry reported that, for the air operations officers acting as pilots, it has actively started to process the overpayments as receivables. It also reported that it has taken steps to inform supervisors and managers of any significant changes to union agreements that would impact rank and file salary, benefits, or classification status.

Finding #2: A lax control environment allowed another Forestry employee to charge excessive and questionable overtime.

Between January 2004 and December 2005, Forestry paid a heavy fire equipment operator approximately $87,000 for 3,919 overtime hours, of which we identified $12,588 that is questionable and $3,445 that is improper.

As opposed to the air operations officers we discussed previously, heavy fire equipment operators are entitled to around-the-clock compensation when they are assigned to a fire. The State's collective bargaining agreement with the firefighters' union provides that heavy fire equipment operators working this employee's schedule work a 12-hour day on the last day of their duty week. This employee improperly claimed 120 hours of overtime by reporting 24-hour shifts on the last day of his duty week, despite being counseled by his supervisor and being specifically told that he should report only 12 hours on the last day of his duty week. As a result, this employee improperly received $2,769. In addition, this employee improperly claimed 27 hours related to training, receiving $676 for hours he did not work. The aggregate amount of these improper payments totaled $3,445.

Additionally, we question $12,588 paid for 549 hours in which this employee reported hours for covering the shift of another employee who was also scheduled to work these same hours or reported hours for working the shift of another employee who was not scheduled to work.

Although this employee's direct supervisor acknowledged that he was not as diligent as he could have been when approving time sheets, he pointed out that when other battalion chiefs approve this employee's time sheets, he does not review those time sheets for accuracy.

Forestry's Action: Partial corrective action taken.

Forestry agreed that the heavy equipment operator was overpaid and it has started to process a receivable for repayment. Further, Forestry is evaluating adverse action for this employee.

Indian Gaming Special Distribution Fund

Local Governments Do Not Always Use It to Mitigate the Impacts of Casinos, and Its Viability Will Be Adversely Affected by Compact Amendments

REPORT NUMBER 2006-036, JULY 2007

California Gambling Control Commission's and Six County Indian Gaming Local Community Benefit Committees' responses as of September 2007

Government Code, Section 12717, requires the Bureau of State Audits (bureau) to conduct an audit every three years regarding the allocation and uses of moneys from the Indian Gaming Special Distribution Fund (distribution fund) by the recipients of the grant money and report its findings to the Legislature and all other appropriate entities. We evaluated the use and administration of distribution fund grants at six counties: Fresno, Placer, Riverside, San Bernardino, San Diego, and Sonoma.

We also compared fiscal year 2005–06 distribution fund contributions to estimated future contributions based on changes in compact provisions in new and amended pending compacts to determine the ability of the distribution fund to continue to fund the programs that depend on it. We then compared estimated contributions to current year expenditures from the distribution fund. Because we are unable to project how fast casinos will expand or forecast the changes to their profitability, we made a conservative estimate based on fiscal year 2005–06 gaming device counts and net win figures.

In his fiscal year 2007–08 veto message, the governor deleted the appropriation for grants to local government agencies to mitigate the impact of casinos. However, Assembly Bill 1389 (AB 1389) would appropriate $30 million from the distribution fund to provide grants to local jurisdictions subject to several provisions. Finally, several counties stated in their response that the recommendations addressed to their respective Local Community Benefit Committee (benefit committee) for improving the process would not be considered until funding is restored.

Finding #1: Local governments did not always use the distribution fund to pay for mitigation projects.

The legislation establishing the distribution fund declares the intent of the Legislature that tribal governments participate in identifying and funding mitigation of the impacts of tribal gaming through the grant process. The legislation also states that the grants are for distribution to local governments impacted by casinos. Finally, the senate floor analysis describes the legislation creating the distribution fund and grant process as establishing "priorities and procedures . . . for the purpose of mitigating impacts from tribal casinos." However, the legislation does not establish a clear requirement that the grants be used only for projects that actually mitigate the impacts from tribal casinos in all instances.

Audit Highlights . . .

Our review of the allocation and uses of the Indian Gaming Special Distribution Fund (distribution fund) money revealed the following:

- *Local governments did not always use distribution fund money to mitigate casino impacts.*
- *The allocation of distribution fund money in some counties is based, in part, on the number of devices operated by tribes that did not pay into the fund because their compacts require them to negotiate directly with the county to pay for the mitigation of casino impacts. However, these counties continue to receive distribution fund dollars from the State.*
- *In many instances local governments do not use interest earned on unspent distribution fund money for projects related to casino impacts.*
- *Although all benefit committee members are required to file statements of economic interests, in our sample counties, 11 of the 13 tribal members that were required to file failed to do so.*
- *The ratification of compacts in June 2007, along with one that is awaiting ratification, may threaten the future viability of the distribution fund and the programs that depend on it, as they eliminate $92 million in payments to the fund beginning in fiscal year 2007–08. While we estimate that contributions to the State's General Fund would also total at least $174 million, almost $40 million per year could be required to pay for the estimated shortfall in the Revenue Sharing Trust Fund.*

Based on our review of 30 grants, we determined that often a distribution fund grant financed a project that had the potential of offsetting the repercussions of a casino but was mainly used for activities that benefited the county as a whole. In 10 instances, the goods and services purchased with grant money had the potential for use in mitigating casinos' impact, should the need arise. However the main beneficiaries were the counties as a whole. Even though the potential exists that some of the goods or services acquired with these grant funds could be used to mitigate the impact of a casino, it is unclear whether the Legislature intended distribution fund grants to be used in this manner. In other cases grant funds were used for projects totally unrelated to casinos. Specifically, in five instances the money was not used to offset the adverse effects of casinos. Although these and other purchases may be beneficial to the counties, when a distribution fund grant is used for purposes that have little or no relationship to a casino impact, the problems the community experiences because of a casino may not be adequately addressed. The remaining 15 grants we reviewed were used specifically to alleviate casino impacts.

We recommended that the California Gambling Control Commission (gambling commission) seek legislative changes to amend the government code to provide direction to local governments to ensure that they use distribution fund grants only to purchase goods and services that directly mitigate the adverse impacts of casinos on local governments and their citizens.

We also recommended that benefit committees require local governments to submit supporting documentation that clearly demonstrates how proposed projects will mitigate the effects of casinos.

Gambling Commission's Action: None.

➲ The gambling commission states that because it does not have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which requires that benefit committees select only grant applications that directly mitigate impacts from casinos, and cause any grant for expenditures not related to Indian Gaming to terminate immediately and revert to the Individual Tribal Casino Account. Further, the bill requires that if an expenditure to mitigate the impact of a casino provides other benefits to the local jurisdiction, the grant may only finance the proportionate share of the expenditure that directly mitigates the impact from the casino. This bill was referred to the committee on governmental organization on December 13, 2007.

Fresno County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it is working with staff to codify more comprehensive descriptions and procedures for the management of funds, and their award and distribution. These procedures will be reviewed at a benefit committee meeting on November 30, 2007. However, the benefit committee also stated that it believes it is contradictory for the report to imply that some expenditures adhere to the explicit requirements of the law without meeting the intent of the law.

Placer County Indian Gaming Benefit Committee's Action: None.

➲ Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that the process in place requires applicants to describe the impact they propose to mitigate and how they will do so. However, the benefit committee indicated that during the next award cycle staff will review the descriptions in sponsored applications and provide an assessment on each application's apparent relevance to casino and gaming impacts.

San Bernardino County Indian Gaming Benefit Committee's Action: None.

The benefit committee states that it will continue to use its current application process, which includes a requirement that the applicant provide a detailed project description and information that demonstrates how the project will mitigate the effects of casinos; a procedure which does not differ from that in practice when the grants we reviewed were approved.

San Diego County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that in the next cycle of grants the application form will be amended to add a requirement that if only a small part of the project proposes to mitigate impacts related to casinos, funding for the portion of the project that provides benefits unrelated to impacts from casinos be funded from another source. However, while the benefit committee also plans to remind applicants to describe the impact on their jurisdiction and explain how their project will mitigate those impacts, this procedure does not differ materially from that in practice when the grants we reviewed were approved.

Sonoma County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it has adopted an application form that requires grant applicants to provide a complete project description, describe the impacts on their jurisdiction associated with the casino and include any data supporting the request for funds, and explain how the project will mitigate these impacts.

Finding #2: Compacts ratified since 1999 require tribes to directly fund efforts to mitigate casinos' impacts, but local governments continue to receive distribution fund money.

Post-1999 compacts require tribes to negotiate directly with local governments to pay for local mitigation projects in lieu of paying into the distribution fund. However, based on the allocation methodology established in state law in 2004, two counties where casinos under post-1999 compacts are located received roughly $850,000 in distribution fund money in fiscal year 2005–06. Local governments in those counties received money for projects that, in accordance with the post-1999 compacts, should have been funded directly by the tribes. Consequently, less distribution fund grant money is available to other counties where tribes are not required to provide funding directly to local governments.

We recommended that the gambling commission seek changes to legislation to revise the allocation methodology outlined in the government code so that the allocation to counties is based only on the number of devices operated by tribes that do not negotiate directly with local governments to mitigate casino impacts.

Gambling Commission's Action: None.

The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Finding #3: Interest that local governments earned on unspent distribution fund money has not always gone toward mitigation projects.

Some local governments have earned interest on distribution funds until the funds are needed for an intended project. In many instances, large amounts of grant money remained unspent for more than a year, and the local governments indicated to us that the interest earned was not always allocated back to the original project or used for similar future projects. In fact, several local governments we spoke to used the interest to pay for general county operational costs. In some cases local governments did not even earn interest, instead depositing the grant funds in accounts that generate no interest.

Our legal counsel advised us that although the law does not specifically require a local government to allocate interest earned on unspent funds to original or future mitigation projects, the government code section cited by local governments states that earned interest may be deposited in their general funds unless otherwise specified by law. The purposes for which distribution fund money may be spent are set forth in the compacts and state law. Accordingly, our counsel advised us that the interest on distribution fund money is subject to the common law rule that unless it is separated by statute from the principal, the interest should be used for the originally intended purpose. Thus, we believe the interest should be used to support mitigation projects. However, several local governments asserted that the government code grants them authority to use interest earned for general purposes. Further, local officials indicated that a significant number of grants were maintained in accounts that earned no interest. Because the interest on distribution fund money is subject to the common law rule that unless it is separated by statute from the principal, the interest should be used for the originally intended purpose, we believe the interest should be used to support mitigation projects.

We recommended that the gambling commission seek changes to legislation to amend the government code to require that all funds be deposited into interest-bearing accounts, and that any interest earned is used on projects to mitigate casino impacts.

Further, we recommended that benefit committees ensure that local governments spend the interest earned on project funds only on the projects for which the grants were awarded or return the money to the county for allocation to future mitigation projects.

Gambling Commission's Action: None.

➲ The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which requires any jurisdiction that receives a grant from an individual tribal casino account to deposit all funds received in an interest bearing account and use the interest from those funds only for the purpose of directly mitigating an impact from a casino. This bill was referred to the committee on governmental organization on December 13, 2007.

Placer County Indian Gaming Benefit Committee's Action: None.

➲ Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee stated that it has sent letters to all mitigation grant recipients clarifying the need to maintain mitigation grant funds in interest bearing accounts and the required use of interest earned for casino/gaming mitigation measures.

San Bernardino County Indian Gaming Benefit Committee's Action: Corrective action taken.

The county stated that it has changed its contract language to ensure that interest earned on distribution funds for long-term capital projects will remain with the project. Material amounts of grant money for long-term projects that remain unspent will be required to be deposited into an interest bearing account. All interest earned will be allocated back to the original projects or used for future mitigation projects.

San Diego County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that it will instruct applicants to either spend the interest earned on projects that mitigate impacts or return the interest to the benefit committee for allocation to future mitigation projects, if state law allows it to do so. However, the benefit committee also states that it disagrees with the bureau's interpretation of state law and that another section of the government code requires it to separate the interest from the principal and deposit it in the benefit committee's general fund.

Sonoma County Indian Gaming Benefit Committee's Action: None.

The benefit committee states that it disagrees with the recommendation and that absent changes to state law, will not change its procedures.

Finding #4: Grant allocations have generally been properly calculated, but some local governments were not awarded the amounts they were allocated through the Nexus test.

State law requires a county receiving distribution fund money to allocate a portion of its funding to local governments based on the Nexus test criteria described in the text box. In Riverside County, we identified two instances where the Nexus test criteria were not consistently applied. County officials agreed with our assessment and stated that the county would revise its application of the Nexus criteria. Further, Riverside County did not even adhere to its inaccurate Nexus test calculation. We identified several instances where cities in Riverside County were awarded less money than they should have been allocated under the Nexus test.

We recommended that benefit committees correct the inconsistent application of Nexus test criteria and ensure that local governments receive at least the minimum amounts they are allocated under the government code requirements.

Nexus Test Criteria

1. The local government jurisdiction borders Indian lands on all sides.
2. The local government partially borders Indian land.
3. The local government maintains the highway, road, or predominant access route to a casino within four miles.
4. All or a portion of the local government is located within four miles of a casino.

Riverside County Indian Gaming Benefit Committee's Action: None.

The benefit committee stated that the county has updated its information identifying how many Nexus test criteria local governments meet in order to determine what percentage share of the Nexus grant funds they are eligible to receive. However, statements in the benefit committee's response indicate that it is confused regarding the application of the formula to these corrected criteria. The committee seems to hold the mistaken impression that each local government receives a percentage of the money, rather than, as described in law and our report, each local government is entitled to an equal share of the percentage allotted to local governments meeting the same number of criteria.

Finding #5: Some grantees were not eligible for funding.

Although state law defines the intended recipients of distribution fund money—cities, counties, and special districts—some benefit committees provided grant money to ineligible entities. In two cases benefit committees awarded grants to school districts, which state law specifically excludes from the definition of special districts. Because the Legislature has identified specific entities and purposes for distribution fund grant money, counties must ensure that they follow the statutory requirements.

We recommended that benefit committees grant distribution fund money only to eligible entities.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which—for the purposes of this program—excludes school districts from the definition of "special district." This bill was referred to the committee on governmental organization on December 13, 2007.

Fresno County Indian Gaming Benefit Committee's Action: Pending.

The Fresno County Indian Gaming Local Community Benefit Committee (Fresno) states that it is working with staff to codify more comprehensive descriptions and procedures for the management of funds, and their award and distribution. These procedures were scheduled to be reviewed at a meeting on November 30, 2007.

Riverside County Indian Gaming Benefit Committee's Action: None.

➲ The benefit committee did not address our recommendation.

Finding #6: Some benefit committee members fail to meet disclosure requirements.

The Political Reform Act of 1974 (political reform act) requires state and local officials and employees with decision-making authority to file statements of economic interests annually and on assuming or leaving a designated position. These statements are intended to identify conflicts of interest that an individual might have. However, the counties we visited could not provide 11 of the 13 statements of economic interests for tribal representatives on the benefit committees for fiscal year 2005–06.

Three of the six counties we visited informed us that the tribal members of their respective benefit committees asserted that they are exempt from the requirements to submit statements. However, the California Fair Political Practices Commission has issued an advice letter regarding this issue stating that any individual serving in a capacity as a member of a public agency, including tribal members of benefit committees, are subject to the provisions of the political reform act. The remaining three counties indicated that they do not know the reasons tribal members did not file the required statements. When designated individuals do not file statements of economic interests, benefit committees may be unaware of conflicts of interest. Further, the benefit committees cannot ensure that members are aware that they should remove themselves from making decisions that may pose conflicts of interest.

We recommend that benefit committees ensure that all benefit committee members follow the political reform act and file the required statements of economic interests, and inform the appropriate agency if they fail to do so.

Fresno County Indian Gaming Benefit Committee's Action: None.

➲ The Fresno County Indian Gaming Local Community Benefit Committee (Fresno) states that in spite of the California Fair Political Practices Commission's advice letter, it is the position of the benefit committee that as members of a sovereign nation, tribal members are exempt from the requirement.

Placer County Indian Gaming Benefit Committee's Action: None.

➲ Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Pending.

The benefit committee states that the county is working with tribal members and anticipates resolution of this issue by October 31, 2007.

San Bernardino County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will continue to inform members of the requirement to file their statements at intervals before and after the deadline, and will notify the appropriate state agency if they do not file within two weeks of the deadline.

San Diego County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that they will remind benefit committee members to submit required statements and will inform the State of any failure by a benefit committee member to do so.

Sonoma County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee indicates that they will continue to ask all members to submit required statements of economic interests and will inform the appropriate state agency if they fail to do so.

Finding #7: Many counties did not properly report their use of distribution fund money.

State law requires each county that receives distribution fund grants to submit an annual report by October 1 each year detailing, among other information, the specific projects funded by the grants and how current-year grant money has been or will be spent. Nevertheless, many counties fail to submit the reports to all required entities. In fact, according to the gambling commission and various legislative committees, in 2006 only nine counties reported to all required entities, which include the gambling commission, the chairs of the Senate and Assembly committees on governmental organization, and the chair of the Joint Legislative Budget Committee. Furthermore, six of the 24 counties receiving funds did not report at all.

We recommended that the gambling commission seek changes to legislation to amend the government code to allocate distribution fund money only to counties that submit annual reports as required.

Further, we recommended that benefit committees submit complete annual reports to all required legislative committees and the gambling commission.

Gambling Commission's Action: None.

The gambling commission states that because it does not already have an oversight role related to local mitigation grants and its existing role is purely technical, it declines to seek the suggested legislative changes.

Legislative Action: Pending.

Assemblymember Torrico authored AB 1389, which designates any county that does not provide an annual report pursuant to the government code requirements as ineligible for funding from the distribution fund for the following year. This bill was referred to the committee on governmental organization on December 13, 2007.

Placer County Indian Gaming Benefit Committee's Action: None.

Placer County officials declined our request to provide a response to the audit.

Riverside County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will provide information for grants funded in the current fiscal year in its next annual report.

Sonoma County Indian Gaming Benefit Committee's Action: Corrective action taken.

The benefit committee states that it will submit annual reports to all required legislative committees and the gambling commission by the deadline specified in state statute.

Finding #8: New compact provisions will change the amount of revenues in the distribution and trust funds.

In June 2007 the Legislature ratified one new compact and four of five amendments to existing compacts—the fifth compact amendment was ratified after our audit. From a review of current operating information and compact terms, we estimated that the one new compact and five amendments (pending compacts) to existing compacts would significantly decrease revenues in the distribution fund and, to a lesser extent, increase Revenue Sharing Trust Fund (trust fund) revenues. We conservatively estimated that annual contributions to the trust fund from these compacts would increase by about $6.9 million, while annual contributions to the distribution fund would decrease by $92 million. If the revenue and expenditure levels estimated for fiscal year 2007–08 continue into the future, without additional resources the distribution fund will be unable to meet its obligations by fiscal year 2010–11, approximately four years from now. In addition to the impact on the distribution and trust funds, we estimated that contributions to the State's General Fund from these compacts would total between $174.3 million and $175.1 million for fiscal year 2007–08. Further, as casino operations expand, General Fund revenues will increase.

Finding #9: Post-1999 and pending compacts and amendments provide revenues to the General Fund.

Between 2003 and 2006, the Legislature ratified five new compacts and amendments to eight others (post-1999 compacts), which provided $128 million in General Fund revenue in fiscal year 2005–06. However, that figure will increase because several casinos operating under post-1999 compacts only recently began operations or will begin operations this year. Overall, we estimated that General Fund revenues for fiscal year 2007–08 from the post-1999 and pending compacts discussed above will total between $304 million and $313.5 million. These amounts represent between 4.3 percent and 4.5 percent of the $7 billion in revenue that Indian gaming in California generated during fiscal year 2004–05. Further, for fiscal year 2007–08, we estimated that trust fund and distribution fund revenue from tribal contributions will total $39.4 million and $47 million, respectively, representing 0.6 percent and 0.7 percent of total fiscal year 2004–05 gambling revenue, respectively.

Finding #10: General Fund revenues may be used for many purposes.

Future General Fund revenue contributions from Indian gaming may be used to help reduce the impact of the $92 million decrease in distribution fund revenue. However, without further clarification in the government code by the Legislature, it is unclear if compact provisions that redirect a portion of their General Fund revenue contributions to the trust fund if there is an insufficient amount in the trust fund to distribute $1.1 million to each eligible tribe take place before or after the government code requirement for the distribution fund to cover any such shortfalls in the trust fund. Furthermore, the General Fund contributions required by the compacts may also be obligated to repay a California Department of Transportation fund that made loans to the General Fund in prior fiscal years. As such, any increase in General Fund revenue from pending compacts may be obligated to repay the Transportation Congestion Relief Fund and thus would not be available for backfill distributions required by the trust fund or for other purposes.

California Highway Patrol

Investigations of Improper Activities by State Employees, February 2007 Through June 2007

INVESTIGATION I2007-0715 (REPORT I2007-2), SEPTEMBER 2007

Investigative Highlights . . .

The California Highway Patrol:

» *Paid $881,565 for 51 vans it had not used for their intended purposes more than two years after it purchased them.*

» *Did not postpone its purchase of the vans until it needed them, resulting in $90,685 in lost interest earnings to the State.*

California Highway Patrol's response as of November 2007

We investigated and substantiated an allegation that the California Highway Patrol (CHP) wasted state funds when it purchased numerous vans that it left virtually unused for at least two years.

Finding: The CHP wasted state funds.

Using three purchase orders, the CHP bought 51 vans for its Motor Carrier program, surveillance, and mail delivery. However, as of June 30, 2007, the 30 vans purchased in October 2004 and the 21 vans purchased in August 2005—at a combined cost of $881,565—had not been used for the special purposes for which they had been purchased. In addition, the CHP has left all but five of the 51 vehicles virtually unused since it purchased them. Further, because the CHP did not postpone its purchases of the vans until it needed them, the State lost interest earnings of approximately $90,385.[1]

The CHP intended to use 48 vans for field inspections in its Motor Carrier program, two vans for surveillance purposes, and one van for mail delivery. Vehicles must be specially modified before they can be put to use for field inspections, surveillance, or mail delivery. However, the CHP does not expect to have any of the 48 vehicles that it purchased for field inspections modified and available for that use until October 2007—more than two years after they were purchased. The CHP completed the necessary modifications to the mail van in June 2007, and as of August 2007 it reported that the modifications to the two surveillance vans were only 50 percent complete because of the State's failure to approve a budget in a timely manner.

In addition, our review of vehicle mileage information shows that the CHP left 46 of the 51 vans almost entirely idle, parked on the CHP property in an outdoor location. Specifically, we determined that as of April 2007 the CHP had driven the 46 vans a total of only 401 miles—an average of nine miles for each van—since it had purchased them in 2004 and 2005. We found that 14 vans had not been driven at all, another 27 vans had been driven from one to 20 miles, and five vans had been driven from 21 to 34 miles. Most of the mileage related to trips to facilities where various items such as roof vents, antennas, and flooring needed to modify these vehicles for their intended purpose were installed. The CHP used the remaining five vans for temporary assignments or to transport equipment. As of April 2007 the Highway Patrol had driven each of the five vans between 167 and 3,420 miles, or an average of 1,901 miles.

[1] This amount is based on interest rates available to the State through its Pooled Money Investment Account Earning Yield Rate.

The CHP gave several reasons for not using the 51 vans for their intended purposes between the time it purchased them in 2004 and 2005 and the completion of our investigation in June 2007. The CHP told us that it planned to assign the vans to the field in fiscal year 2006–07. Further, it stated that modification of the vans had been delayed because of competing priorities, staff shortages, and the development of an equipment strategy that could meet all its users' needs. The CHP officials we interviewed told us that the vans were originally intended for modification and use within the CHP's normal replacement cycle time of approximately 18 months from purchase. However, the CHP stated that because of its workload, the labor-intensive installation of equipment in the two vehicles it purchased for surveillance was delayed beyond the normal cycle. In addition, the CHP officials stated that, although it completed modifications to the mail van, the CHP did not plan to use it until the mail van it was intended to replace either reaches the replacement mileage target of 150,000 miles or was no longer cost-effective to operate. Further, the CHP stated that modification of the 30 vans it received in October 2004—originally scheduled for April 2006—was canceled because of an unforeseen increase in demand for marked patrol cruisers. However, it appears the CHP had not yet developed an equipment strategy for the Motor Carrier program vans at the time it was modifying the marked patrol cruisers.

The CHP did not develop a workable strategy to make the 48 vans it purchased for the Motor Carrier program available for field use prior to making the purchases in 2004 and 2005. We believe the primary cause for delays was the CHP's attempt to develop a prototype vehicle design that could meet the needs of all of its employees who perform field inspections. The CHP developed two prototypes and it expected to complete the second prototype in September 2007, more than two years after it received its first shipment.

CHP's Action: Corrective action taken.

The CHP stated it had revised its fleet operations manual to address the manner in which its vehicles are equipped, painted, and marked. It also now requires the CHP commissioner's approval for any vehicle modifications or redesign.

In addition, the CHP stated that delays in equipping the vans were not due to the lack of a workable strategy but were instead the result of its decision to cease its normal process of equipping the vehicles under its existing configuration while awaiting the completion of the prototype. Further, the CHP stated that as of November 6, 2007, all 51 vans had been assigned to locations across the state.

Finally, the CHP asserted that, had it delayed the van purchases until the equipment design was resolved, it would have spent $235,233 more for 51 vans than it did for the vans mentioned in our report. Thus, the CHP believes that because it incurred no additional cost to store the vehicles on its property, its decision to purchase these vans more than two years before they were needed or used represents a savings of $235,233. We disagree with this assertion because it ignores the $90,385 in interest the State would have earned if the funds had remained in the State Treasury. Further, the CHP's analysis does not recognize the difference in product quality and resale value of the 2007 and 2008 model year vehicles when compared to the 2004 and 2005 model year vehicles it purchased.

Emergency Preparedness

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

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 September 2007

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.

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.***

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.

According to Emergency Services, it is putting together a statewide exercise strategy that would include currently scheduled exercise programs such as Golden Guardian and Statewide Medical and Health. It stated that the strategy will also include any exercise needs identified as a result of a training needs assessment and as training needs are met, that training will be tested as part of an exercise. Emergency Services also told us that it had released a draft of the exercise strategy to its partnering local and state agencies and is collecting their changes and additions for inclusion in the document. It believes it will implement the program in December 2007.

Emergency Services did not address that portion of the recommendation related to ensuring that future exercises are as realistic as possible.

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

State Homeland Security did not address this recommendation in its one-year response to our audit. However, in its earlier responses, 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 State Homeland Security continue to work cooperatively and are committed to reducing the processing time for all reimbursement claims. It also stated that the two offices currently process claims in an average of 35 days from receipt and the goal is to reduce the time to the 30 days mentioned in state law. According to Emergency Services, it expects to reach the 30-day goal by September 30, 2007.

State Homeland Security's Action: Corrective action taken.

According to State Homeland Security, it will continue to create many forums for local first responders and administrators to share best practices and concerns. It cited its Program and Capability Review (review) as one example of such a forum. State Homeland Security stated that as part of this review, local agencies participated collaboratively with it in the grant application process and identified needs for local, regional, and statewide preparedness. It also stated that the review allowed local agencies to discuss grant issues with colleagues from around the State. State Homeland Security also mentioned it hosted two statewide conferences, which included panel discussions concerning grant monitoring and audit requirements.

Regarding a collaboration to reduce the amount of time necessary to reimburse local jurisdictions, State Homeland Security stated that it and Emergency Services established timelines for processing and approving local reimbursement requests. State Homeland Security also stated that it has reduced the average time for its payment approval and transmittal to Emergency Services to 10 days or less, with the vast majority of claims being processed in four days or less.

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: Corrective action taken.

According to Emergency Services, it established a password-protected database designed to track its own plans and planning-related documents and those of other state and local agencies. It stated that the attributes tracked on this database include the adoption dates of the plans, the dates of required or advised updates, and the status of plans under development or review. Emergency Services also stated that it has assigned staff to oversee the database and to monitor the development and updating of emergency plans. Finally, it stated that it is working with state agencies and operational areas to enter planning information into the database and that the database was operational as of September 2007.

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. (NOTE: Effective July 1, 2007, the newly created Department of Public Health (Public Health) took over specified responsibilities from the Department of Health Services. Further, the State renamed the Department of Health Services as the Department of Health Care Services (Health Care Services). Although the responsibility for public health emergency preparedness now rests with Public Health, information we received indicates that the responsibility for reviewing cost reports resides with Health Care Services.)

Public Health's and Health Care Services' Actions: Corrective action taken.

According to Public Health, Health Care Services developed the audit protocols and audit programs for auditing subrecipients of federal bioterrorism preparedness funds. Public Health also stated that Health Care Services began audits of local health departments in February 2007. Finally, Public Health indicated that although Health Care Services was using existing staff to perform the audits, Health Care Services was recruiting to fill three full-time audit positions authorized by the budget for fiscal year 2007–08.

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, we recommended the following steps be taken:

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

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

- The Legislature 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 could consider statutorily defining the relationship between State Homeland Security and Emergency Services.

Legislative Action: Legislation proposed.

According to Emergency Services, Assembly Bill 38 (AB 38) is the administration-sponsored bill to clarify organizational responsibilities for all-hazards disaster preparedness. Enacting AB 38 would create the Department of Emergency Services and Homeland Security. This new department would be vested with the duties, powers, purposes, responsibilities, and jurisdiction of the current Office of Emergency Services and the current Office of Homeland Security. The Assembly passed this bill in May 2007. As of December 2007, AB 38 is pending in the Senate.

Department of Housing and Community Development

Awards of Housing Bond Funds Have Been Timely and Complied With the Law, but Monitoring of the Use of Funds Has Been Inconsistent

REPORT NUMBER 2007-037, SEPTEMBER 2007

Department of Housing and Community Development's response as of November 2007

In November 2002 and 2006, California voters passed the Housing and Emergency Shelter Trust Fund acts to provide bonds (housing bonds) for use in financing affordable housing for low- to moderate-income Californians. The Department of Housing and Community Development (department) and the California Housing Finance Agency (Finance Agency) manage the programs funded by the housing bonds.

The California Health and Safety Code, sections 53533 and 53545, requires the Bureau of State Audits to conduct periodic audits of housing bonds activities to ensure that housing bond proceeds are awarded in a manner that is timely and consistent with legal requirements and that awardees use the funds in compliance with the law.

Finding #1: Awards of housing bond funds were timely.

The department and Finance Agency have generally met and sometimes exceeded the goals specified in awards schedules they established in 2002 and 2003 for the 2002 housing bonds. For all complete fiscal years we audited, except fiscal year 2002–03, actual awards exceeded estimated awards.

Finding #2: The department and the Finance Agency generally complied with legal requirements when awarding housing bond funds.

The department and the Finance Agency generally allocated and awarded housing bond funds for the intended programs, to the correct types of sponsors, and for the proper activities. We noted that the Finance Agency's California Homebuyer's Downpayment Assistance Program (Downpayment Assistance Program) and the department's CalHome, Joe Serna Jr. Farmworker Housing (Farmworker Housing Program), and Multifamily Housing programs complied with legal requirements. However, poor file management in the department's Emergency Housing and Assistance Program (Emergency Housing Program) made it impossible for us to verify if the department always assessed applicants' submissions according to criteria for their capability as set forth in program notices. These criteria include minimum standards.

We recommended that the department implement record-keeping procedures for the Emergency Housing Program to ensure that applicants who receive awards have been properly evaluated.

Audit Highlights . . .

Our review revealed that for the Housing and Emergency Shelter Trust Fund Act of 2002:

- *Both the Department of Housing and Community Development (department) and California Housing Finance Agency (Finance Agency) generally awarded funds in a timely manner.*
- *Both the department and Finance Agency generally complied with legal requirements for making awards; however, the department could not provide its rating and ranking tools in some cases for its Emergency Housing and Assistance Program (Emergency Housing Program).*
- *Both the department and Finance Agency generally used appropriate monitoring procedures during the expenditure phase, but the department sometimes overrode controls concerning advance payments for the CalHome Program.*
- *The department does not exert adequate monitoring over the completion phase for two of its programs—Emergency Housing and CalHome.*

Department's Action: Pending.

The department reports that it drafted standardized record filing and maintenance procedures for the Emergency Housing Program and expects to finalize the procedures by the end of October 2007. In addition, by February 2008 the department anticipates the file review and organization effort will be completed.

Finding #3: The department and the Finance Agency generally undertake appropriate monitoring procedures during the expenditure phase.

For the expenditure phase (the period from award commitment to final state payment to an awardee), the department and the Finance Agency have processes in place to ensure that awardees exhibit reasonable progress in meeting their goals and are only reimbursed for allowed costs. However, we found that for three of the 18 CalHome awards tested, 17 percent of our sample, sponsors received advances exceeding the 25 percent limit established in their standard agreements. For example, the department approved a 100 percent advance on the last day funds were available for disbursement to one awardee based only on a list of potential home buyers. In these cases, the department overrode what appears to be a reasonable policy to ensure the delivery of services close to the time of payment and to maximize the State's interest earnings. Had the department retained the funds advanced over the 25 percent threshold for the three awards, we estimate it could have earned $42,000 in interest through July 2007 based on the effective yield of the State Treasurer's Office pooled money account.

We recommended that the department consider eliminating its process of overriding restrictions on advances for the CalHome Program.

Department's Action: Pending.

The department stated that it is establishing clear procedures to guide staff in evaluating circumstances in which an advance above the 25 percent limitation may be appropriate and documenting the justification received from the awardees. The department indicated that these procedures will ensure that exceptions are allowed only after there is clear documentation that the awardee has a proven history of making loans on a timely basis and that the amount requested is reasonable in consideration of the anticipated loan closing schedule.

Finding #4: For two programs, the department does not have adequate monitoring processes for the completion phase.

Of the five programs we reviewed, only Downpayment Assistance, Farmworker Housing, and Multifamily Housing had processes in place to adequately ensure compliance during the completion phase. This phase extends from the final state payment to fulfillment of all contract requirements. However, the CalHome and Emergency Housing programs administered by the department had weak or nonexistent monitoring during the completion phase. Consequently, the department cannot always be certain that sponsors are using bond funds to help intended beneficiaries, such as low- to moderate-income home buyers or homeless individuals.

We found that for 17 of the 18 CalHome Program awards we tested, the department had not verified any of the information provided whether through site visits or by reviewing original documentation, even though the sponsors had received all funds. For the remaining award, the sponsor had not yet received any funds. As a result, the department cannot be certain that sponsors complied with housing bond requirements related to occupants' income limits or their status as first-time home buyers.

Similarly, for the Emergency Housing Program, we found that the department had not performed site visits to verify sponsor activities for any of the awards we tested that were in the completion phase. Moreover, the program manager said that the program has not performed any site visits since 2005 and even then, it did not have formal policies and procedures governing the purpose and documentation

requirements for site visits. Without monitoring processes for verifying compliance, the department cannot ensure that sponsors use funds in accordance with housing bond requirements or that the program benefits the intended populations.

We recommended that the department give high priority to finalizing and implementing monitoring procedures for the CalHome and Emergency Housing programs, which do not currently have such procedures in place. In addition, we recommended that the department review its other housing bond programs that were not specifically evaluated in this initial audit to ensure that monitoring procedures are in place and operating.

Department's Action: Partial corrective action taken.

The department stated that it completed monitoring of eight CalHome awards. The department anticipates it will finalize and implement its new risk assessment procedure and monitoring program design in January 2008. In regards to the Emergency Housing Program, the department says it has developed draft criteria for selection of projects to be monitored and anticipates finalizing monitoring procedures no later than January 2008.

The department indicates it completed its review of the bond programs not included in the audit to determine whether appropriate in-progress and post-completion monitoring processes are in place. The department stated that for all but two housing bond programs now operating, monitoring processes were appropriate. For the two identified programs, the department's Audit Division is revising its audit plan to assure that awardees are carrying out their responsibilities. For new housing bond programs, the department stated that development of the monitoring processes will be a second step of the program design procedures that are currently underway.

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

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.

Investigative Highlight . . .

A Department of Industrial Relations employee improperly used bereavement leave for work missed while incarcerated.

Department of Industrial Relations

Its Division of Apprenticeship Standards Inadequately Oversees Apprenticeship Programs

REPORT NUMBER 2005-108, SEPTEMBER 2006

Labor and Workforce Development Agency's response as of August 2007

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 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.

[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.

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.*
- *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.*

continued on next page . . .

» *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.*

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 on the first recommendation; no action taken on the second recommendation.

The division stated that it filled its consultant and field support vacancies and that for fiscal year 2007–08 it received a staffing augmentation of four new consultants who will specifically focus on audits. It also indicated that by late August 2007 it had completed 13 audits and had six more audits in process or scheduled to begin by the end of September 2007. The division says it is proceeding with audits as currently required by statute and regulations, and has not developed revised legislation 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 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: Corrective action taken on the first and second recommendations; no corrective action taken on the third recommendation.

The division said that complaints have been assigned to one individual at its headquarters, 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 agency indicates that the complaints backlog has been mostly cleared with only 10 pre-2007 complaints still open, all in the hearing phase.

The division says that the U.S. Department of Labor does not recognize California's authority to approve apprenticeship programs for federal purposes in March 2007. As such, it has suspended federally required Cal Plan audits. Instead, the division has implemented reviews of programs' selection procedures during regular visits and during audits of programs. These reviews have led to the revision of several program standards in order to bring the standards into sync with the actual practice of the programs. 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, it has developed performance measurements for the standards and has set priorities related to oversight activities. The division also indicated that compliance with annual self-assessment reviews is very high and that staff are now working with programs to improve the quality of the self-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: Corrective action taken on the first and second recommendations; no corrective action taken on the third recommendation.

The division stated that the Legislature has received reports for 2003 through 2006. In addition, it says it has created an annual calendar that includes a task for submitting the report by April 1st of each year.

The division said that $1.2 million in grants for fiscal year 2006–07 were distributed in December 2006. Further it stated that the fiscal year 2007–08 budget includes an increase in the distribution authority to $3 million, which should be distributed by mid-September 2007. 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 the 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: Partial corrective action taken.

The division stated that consultants have been aggressively working with programs to synchronize program and division records. It also says that its roll-out of the electronic transmission of apprentice registration and drop forms has been moving more slowly than planned, but about 30 percent of apprentices are now being reported electronically. The division did not mention any effort it had made to use data to set performance goals or to pinpoint program successes or failures.

Judicial Council of California

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

REPORT NUMBER 2005-131, AUGUST 2006

The Judicial Council of California's Administrative Office of the Courts' response as of August 2007

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.

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.*

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: Corrective action taken.

The Rules of Court adopted by the Judicial Council require judicial officers to maintain records that show participation in judicial education. Additionally, 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 in December 2006 the governing committee began, with the involvement of the advisory committees for trial court presiding judges and court executives, to develop a form for presiding judges to use to track judges' participation in judicial education. Subsequently, the governing committee submitted its recommendation of the form to the Executive and Planning Committee of the Judicial Council in March 2007, at which time the recommendation for the form was approved. AOC staff created both manual and automated versions of the forms in late July 2007, and requested presiding judges to use the forms to track judges' participation in judicial education for the three-year period beginning January 1, 2007.

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, it planned to begin conducting annual reviews of all program offerings to ensure the goals of the curriculum-based approach are met.

City of Los Angeles

Outside Counsel Costs Have Increased, and Continued Improvement in the City's Selection and Monitoring Is Warranted

REPORT NUMBER 2004-136, JANUARY 2006

City of Los Angeles, Office of the City Attorney's response as of March 2007 and the City of Los Angeles, Office of the City Administrative Officer's response as of August 2006

The Joint Legislative Audit Committee (audit committee) directed the Bureau of State Audits to review the City of Los Angeles' (City) contracting practices for outside legal services. Specifically, the audit committee asked us to:

- Review trends in the use of outside legal services in recent years, including costs associated with outside consultants and experts.
- Assess the potential impact of legal expenses on the City's budget.
- Examine the processes the City uses for selecting outside counsel, including justification for noncompetitive processes.
- Determine whether departments sufficiently monitor the services provided by outside legal counsel and associated services such as consultants and experts.

Finding #1: The City's overall outside counsel costs have increased for various reasons.

Annual outside counsel costs for the City increased from $17.5 million in fiscal year 1999–2000 to $31.9 million in fiscal year 2004–05, an increase of more than 82 percent. For the six-year period, outside counsel costs totaled $162.5 million and consisted of both legal fees (costs related to attorneys and paralegals working on cases) and expenses (other goods and services incurred by law firms, such as the costs of expert witnesses and consultants). The proprietary departments—Department of Water and Power (DWP), Los Angeles World Airports (Airports), and the Port of Los Angeles—accounted for some of the largest increases. Typically funded by revenue generated by providing services, each proprietary department is controlled by a board of commissioners rather than the city council and has control over its own funds. The outside counsel costs for those three entities increased from $7.9 million in fiscal year 1999–2000 to $16.2 million in fiscal year 2004–05, an increase of $8.3 million, or about 105 percent. DWP and Airports accounted for most of the overall increase.

The Office of the City Attorney (Attorney's Office) generally cites a lack of expertise and/or staff resources as the reason for retaining outside counsel. In an August 2004 letter outlining certain reforms regarding the use of outside counsel, the city attorney discussed the formation of an outside counsel committee responsible for reviewing and approving all requests for outside counsel. The city attorney's letter also said the

Audit Highlights . . .

Our review of the Office of the City Attorney's (Attorney's Office) use of outside counsel revealed:

» ***The costs for outside counsel have risen from $17.5 million to $31.9 million over the six-year period ending in fiscal year 2004–05.***

» ***The Attorney's Office lacked documents necessary to demonstrate it followed its policies and procedures when assessing the need to retain outside counsel and when performing its role in selecting outside counsel.***

» ***Although its policies for monitoring the work performed by outside counsel provided sufficient direction for good case management, the Attorney's Office did not always follow them.***

» ***The Attorney's Office eliminated numerous charges from outside counsel invoices, but it could improve its invoice review as it paid outside counsel for some costs its policies did not allow.***

committee would review trends in the use of outside counsel and recommend when it would be more prudent to build capacity and hire additional in-house attorneys and support staff. The committee was formed, and according to the Attorney's Office in October 2005, the committee considered trends in the use of outside counsel and ultimately decided to request internal staff to reduce outside counsel costs for cases involving workers' compensation, intellectual property, and labor employment.

We recommended that the Attorney's Office continue its efforts to ensure that the outside counsel committee periodically reviews trends in the use of outside counsel and make recommendations regarding areas in which it would be prudent to build capacity and hire additional in-house attorneys and support staff. The Attorney's Office should consider that information when evaluating its overall staffing needs and requesting resources.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office told us that it continues to periodically review trends in the use of outside counsel and consider this information in developing budget requests for internal resources. The Attorney's Office noted that as part of its budget development process for fiscal year 2007–08, it made such a request for resources to handle certain types of cases.

Finding #2: The City could improve its reporting of outside counsel costs.

Until recently, the City did not have a process to periodically and comprehensively report on the amount that it spent citywide on outside counsel costs. However, in response to questions from a city council member about the City's outside counsel costs, city staff gathered information from various departments and reported citywide information in an October 2004 memorandum (memo). The memo listed outside counsel costs by city department for fiscal years 1999–2000 through 2003–04. In August 2005 the Attorney's Office requested and subsequently received outside counsel cost data from the same departments for fiscal year 2004–05. Using the data reported in the memo and gathered by the Attorney's Office, we performed various tests on the costs paid by the General Fund and the proprietary departments, which constituted 76 percent of the total outside counsel costs over the six years reported. However, we found some significant inaccuracies and inconsistencies in the reported data we reviewed.

Since issuing the October 2004 memo, the City has taken steps that may help improve reporting of outside counsel costs. Noting that members of the city council had expressed interest in having the Attorney's Office provide a periodic report of all outside counsel costs incurred on a citywide basis, the Attorney's Office issued a letter in September 2005 asking city departments to report quarterly on outside counsel costs and to maintain all the necessary source documents substantiating cost data submitted. The letter directed departments to report costs based on payment date, which might help address the inconsistency in reporting we noted during our review. Additionally, the letter asked departments to designate an outside counsel coordinator, which might help decrease inaccuracies and could increase the consistency of reporting.

We recommended that the City ensure that the outside counsel costs it reports are accurate and prepared consistently and that costs are adequately supported by source documentation.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office indicated to us that it continues to work to ensure that outside counsel costs are reported accurately, that the cost reports are prepared consistently and supported by source documentation. In addition, the Attorney's Office believes that reporting of outside counsel costs is significantly improved in accuracy and consistency with the added staff assigned to each proprietary department.

Finding #3: The Attorney's Office lacks necessary information to demonstrate that it follows its needs assessment policy and that its outside counsel recommendations are based on a competitive process.

After the city attorney took office in July 2001, the Attorney's Office established policies and procedures on the use of outside counsel. Those policies and procedures require the Attorney's Office first to establish a need for outside counsel and then to select a firm through either a competitive or noncompetitive process. The selection process culminates in the Attorney's Office making a recommendation to the city council or appropriate board, which makes the final contracting decision. Although the Attorney's Office's December 2001 policy, as enhanced by reforms outlined in an August 2004 memo on the use of outside counsel, are generally sound, they do not require the Attorney's Office to document how it reaches its decisions for recommending outside counsel or to prepare key documents, such as rating sheets and interview notes, when it conducts a competitive selection process. As a result, the Attorney's Office lacks the necessary documentation to demonstrate that it follows its policies and procedures when performing its role in determining the need to contract with outside counsel and selecting a law firm. The reports the Attorney's Office typically prepares and presents to the city council or appropriate board contain recommendations to contract with outside counsel. However, those reports do not provide sufficient evidence of the Attorney's Office decision-making process. Without sufficient documentation of the decision-making process that takes place within the Attorney's Office when determining the need for and selecting outside counsel, the Attorney's Office leaves itself vulnerable to criticisms that its recommendations on outside counsel are not prudent or made in a fair and objective manner.

In November 2005, after we had substantially completed our fieldwork, the Attorney's Office issued a new policy on the use of outside counsel. The policy outlines the procedures for assessing the need for outside counsel and that a brief decision memo will be generated following a request to use outside counsel. It does not specify the nature or extent of the analysis to be included in the decision memo. Further, the policy indicates that the outside counsel committee must oversee the selection process and draft a recommendation as to which firm or firms should be hired. However, it does not require the creation or retention of the documents necessary to demonstrate the fairness and objectivity of the competitive process.

We recommended that to ensure that the decisions it reaches within the outside counsel committee to retain outside counsel are justified in accordance with the policy of the Attorney's Office and to enable it to demonstrate the justification to interested parties, the Attorney's Office should ensure that it follows the new policy of preparing a memo to document each of its decisions. The Attorney's Office should ensure that the memo sufficiently reflects the analysis used in reaching its decision to recommend the retention of outside counsel. Further, to ensure that its recommendations for contract awards are less vulnerable to criticism, the Attorney's Office should develop and implement comprehensive policies and procedures that specify standards for applying evaluation criteria such as the use of rating sheets and retaining documents.

Attorney's Office's Action: Partial corrective action taken.

The Attorney's Office stated that its outside counsel committee prepares memos documenting its decisions to retain outside counsel. In addition, although its July 2006 response indicated that the Attorney's Office was reviewing criteria that might be useful in its outside counsel selection process and hoped to have a review sheet operational by late October 2006; in its one-year audit response, the Attorney's Office noted that it had not found a rating sheet capable of completely and accurately capturing all of the factors it considered when selecting outside counsel. The Attorney's Office stated that it remains open to the recommendation and will continue to explore its implementation.

Finding #4: The Attorney's Office does not adequately document how it justifies using a noncompetitive process.

Under the city charter, the Attorney's Office has the discretion to select outside counsel in a noncompetitive manner. Noncompetitive selection still requires the approval of the city council or the appropriate board. The Attorney's Office has outlined the types of situations in which it uses a noncompetitive selection process. However, it has not established a policy for retaining the documents necessary to demonstrate its decision-making process. The Attorney's Office provided only limited documentation to justify its noncompetitive selection of outside counsel in three of the five contracts we reviewed and had no documentation for two of the selections. As a result, in an area where the Attorney's Office is particularly vulnerable to criticism—selecting outside counsel without a competitive process—it lacks all the necessary documentation to demonstrate how it made its decisions on recommending outside counsel.

In its new November 2005 policy, the Attorney's Office outlined a role for the outside counsel committee with regard to selecting outside counsel in a noncompetitive manner. The November 2005 policy states that in cases in which one firm is uniquely qualified to perform the work, or in which time is of the essence, the committee can recommend a noncompetitive selection process to award the contract. Additionally, the November 2005 policy requires the committee to oversee the drafting of a transmittal recommending to the city council or appropriate board that the firm be selected as a result of the process. However, it does not specify the nature or extent of the analysis to be included in the memo.

We recommended that the Attorney's Office make certain that the outside counsel committee follows the new policy of drafting a memo regarding the firm it recommends for selection. The Attorney's Office should ensure that the memo sufficiently reflects the analysis used by the outside counsel committee in concluding a noncompetitive selection was necessary and appropriate.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office reported that its outside counsel committee prepares memos documenting its decisions, including the decisions to retain outside counsel in a noncompetitive manner.

Finding #5: The Attorney's Office often relied on informal means to oversee its contracts with outside counsel.

The Attorney's Office's policies in place at the time of our fieldwork called for the use of recommended case management tools, such as case budgets and quarterly reports, to help control the costs of outside counsel. Although those policies provided sufficient direction for good case management, Attorney's Office staff did not always follow the policies, often relying on informal monitoring of outside counsel through telephone, e-mail, or in-person communications.

As part of its new policy on the use of outside counsel issued in November 2005, the Attorney's Office revised its standard contract language. Although we reviewed the November 2005 policy and contract, we did not evaluate the Attorney's Office's compliance with it. The November 2005 policy changed the Attorney's Office's monitoring procedures for case budgets and quarterly reports. The use of case plans continues to be discretionary under the new policy.

We recommended that the Attorney's Office require budgets and case plans. Specifically, it should ensure that contracts with outside counsel contain provisions requiring comprehensive budgets and case plans and ensure that the requirements are met. Further, to ensure that its November 2005 policy change of eliminating quarterly reports has not limited its insight into the activities of outside counsel, the Attorney's Office should periodically evaluate its process of obtaining status updates to report to the city council or appropriate board on significant outside counsel cases and modify that approach if necessary.

Attorney's Office's Action: Partial corrective action taken.

The Attorney's Office told us that its outside counsel committee requires budgets when possible prior to retaining outside counsel and in almost all cases before requesting any supplemental funding for an outside counsel contract. In addition, the Attorney's Office reported that its amended outside counsel contract requires both budget and case plans. The Attorney's Office also noted that it is working on including an abbreviated status update on all quarterly financial status reports. It reported that the quarterly financial status reports will supplement the comprehensive biannual reports. In addition, the Attorney's Office told us that is will continue to evaluate the frequency of reporting to ensure that the City Council and various boards are appropriately updated.

Finding #6: The Attorney's Office's policies and procedures for reviewing outside counsel's invoices are reasonable, but it could better identify and eliminate certain questionable costs.

Although its prescribed process for reviewing outside counsel's invoices for contracts paid by the General Fund and proprietary departments is reasonable, the Attorney's Office does not consistently apply its invoicing policies and procedures. In establishing comprehensive invoicing policies and implementing a review process to ensure that outside counsel follow them, the Attorney's Office has helped control outside counsel costs. Our testing of 41 invoices demonstrated that the Attorney's Office often eliminated charges that conflicted with its policies. Nevertheless, we identified certain instances in which the Attorney's Office did not apply its invoicing policies and paid outside counsel for costs that were not allowed. Those costs were primarily related to block billing—the practice of grouping tasks and invoicing for an aggregate amount of time, rather than specifying the time spent and costs associated with each task. In addition, attorneys and paralegal staff were sometimes billed to the City without prior written approval. Although the Attorney's Office's invoicing policies seek to establish a standard for reasonable billing practices and to encourage accountability based on cost-benefit considerations, it undermines those efforts by not consistently identifying all unallowable costs. In addition, the Attorney's Office risks paying more for outside counsel than it has to or is contractually obligated to pay.

We recommended that to help control the costs of outside counsel, the Attorney's Office should enforce its contract requirements and billing guidelines. Specifically, the Attorney's Office should do the following:

- Disallow payment for invoices that it receives in a block-bill format and require that outside counsel resubmit the charges in the prescribed manner.

- Ensure the formal approval of attorneys and paralegals not previously listed on the contracts with outside counsel.

Attorney's Office's Action: Corrective action taken.

The Attorney's Office reported that it continues to strictly enforce all billing guidelines.

Finding #7: The Attorney's Office could more efficiently and effectively monitor outside counsel costs by comparing budgeted to actual costs for activities.

The Attorney's Office could more efficiently and effectively monitor outside counsel costs if it prepared budgets detailed by activity and required outside counsel to submit invoices that had the same level of detail and could thus be compared to the budget. For cases we reviewed in which outside counsel provided budgets to the Attorney's Office, the budgets were in varying formats and showed varying levels of detail.

The Attorney's Office's December 2001 policy stated that managing attorneys should participate in the creation of a litigation budget that describes, in detail, the total estimated cost of outside counsel's assistance in a matter. The policy also directed managing attorneys to periodically compare outside counsel's actual costs against budgeted costs. However, the November 2005 revised policy states that

budget updates are generally required from outside counsel as contract amendments are proposed, and managing attorneys are not required to compare budgeted costs with actual costs. Thus, it appears that reacting to the need for more funding, rather than proactive cost control, now drives budget reviews, because their use is tied to requests for supplemental funding.

Although comparing budgets against actual costs was required by the policy in effect during the period of our audit, our review of selected contracts found no evidence that Attorney's Office staff made the comparisons. Even though Attorney's Office staff ensured that total invoices did not exceed total contract costs and reviewed lengthy invoices that reflected time charged in increments as small as six minutes, this invoice review is labor intensive, and its comprehensiveness and effectiveness are limited. Comparing outside counsel costs to budgeted costs by activity within litigation or project phase should enable the Attorney's Office to better facilitate effective communication on the progress of its cases and any deviations from established budgets.

We recommended that the Attorney's Office require outside counsel to prepare monthly invoices and cumulative cost reports that sort charges both by attorney within activity and by activity within litigation or project phase. Further, the Attorney's Office should compare cumulative charges and estimated remaining charges to agreed-on budgets.

Attorney's Office's Action: Pending.

The Attorney's Office noted only that this recommendation was under review.

Finding #8: The attorney conflicts panel is generally managed appropriately, although the selection of firms for the panel could be better documented.

When the Attorney's Office has an actual or potential conflict of interest—that is, a case in which it cannot ethically represent a city employee whose interests may be adverse to those of the City—it refers the matter to the attorney conflicts panel (conflicts panel). The conflicts panel comprises law firms selected by the Attorney's Office, in conjunction with the Office of the City Administrative Officer (CAO), to provide legal services to the City in the event of a conflict of interest. The selection process culminates in a committee from the Attorney's Office (selection committee) making a recommendation to the city council, which makes the final contracting decision. The major types of litigation for the conflicts panel are cases involving police or employment issues.

In reviewing the process used to evaluate firms responding to the 2005 request for qualifications (RFQ), which took place during our audit, we concluded that the Attorney's Office could better document how it made its decisions when selecting firms to recommend for placement on the conflicts panel. The Attorney's Office has overall responsibility for the selection process, although CAO staff were involved in the process, including participating in the selection committee. It was evident that the selection committee interviewed prospective firms, but it did not sufficiently document its rationale for choosing some firms over others. As in our review of other selection processes that the Attorney's Office conducted, we found that the RFQ that was released cited evaluation criteria, in this case focusing on ability and experience, but that the selection committee could not provide sufficient documentation to support the decisions it made based on the criteria.

The contracts that the City enters into with outside counsel through the CAO contain the CAO's invoicing policy, which is comparable to the policies of the Attorney's Office. The contracts specify the frequency with which outside counsel must invoice the City and the form the invoices must take. The policy included in the contracts places restrictions on certain types of fees and expenses. In addition, the CAO has established an internal process for reviewing outside counsel invoices for compliance with its invoicing policy and disallows costs that do not comply. As a result, the CAO

focuses on eliminating costs for which it is not contractually obligated to pay. Our review of 10 invoices showed that the CAO consistently followed its review process and applied its established invoicing policy by disallowing costs that were not in accordance with its policy.

The CAO's policies for monitoring cases handled by outside counsel are similar to those of the Attorney's Office in that its contracts require outside counsel to submit reports that are useful for monitoring, including budgets and quarterly status reports. The CAO's procedures manual states that the CAO is responsible for ensuring that outside counsel comply with the terms and conditions of its contracts. Our review revealed that the CAO generally has performed an adequate job of monitoring outside counsel. However, we found some contracts that did not require outside counsel to submit budgets.

In a separate finding we recommended that the Attorney's Office develop comprehensive policies and procedures that specify standards for applying evaluation criteria. With regard to the CAO and its oversight of outside counsel, we recommended that in order to help control the costs of outside counsel, the CAO should require budgets for all contracts with outside counsel that it manages.

CAO's Action: Corrective action taken.

The CAO acknowledged the importance of budgets as a mechanism for controlling outside counsel costs. The CAO stated that it will require budgets in all cases that it handles.

Military Department

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

REPORT NUMBER 2005-136, JUNE 2006

Military Department's response as of June 2007

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 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

Audit Highlights . . .

Our review of the 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.*
- *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.*

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- *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.*
- *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.*

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. As of June 2007 the department reports that its reviews and deliberations resulted in a net conversion of 63 positions affecting 102 personnel that will eventually transition to civil service. The department estimates it will take 36 months to complete this transition. As of its one-year response, the department stated that it had reclassified 14 vacant state active duty positions as civil service positions and had downgraded another 12 active duty positions.

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 it has rewritten its regulation regarding state active duty positions. The new regulation establishes a tiered selection process and clarifies tenure status. The department stated that the new regulation would provide oversight to permanent position reviews and facilitates career management of Guard personnel by establishing a career management council (council). The council will meet at least once a year and have the capability and authority to ensure that the department provides guidance to its commanders and directors on placing the right person in the right job at the right time. The department stated that the final coordinating draft of the regulation was undergoing administrative review and the plan was to publish it in July 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. According to the department, it has received an increase in authorized

full-time active guard positions for the joint forces headquarters and has reassigned staff that were previously assigned to headquarters. The department reports that as a result, as of June 2007 it had reduced full-time active guard staff assigned to the joint forces headquarters to nine positions in excess of authorized levels. 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: Corrective action taken.

The department reports that it has completed its reimplementation of a strategic planning process that involved 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.

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: 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 non-counterdrug 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: Pending.

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. The department stated it continues to work with the administration and the Legislature on a substantive benefits package to aid its recruiting and retention efforts. For example, the department is pursuing legislation that would provide tuition assistance, health care, vehicle license exemptions, state income tax exemptions, and several other credits and incentives.

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: 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 has updated 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.

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: Corrective action taken.

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.

Further, the department reports that an adequate baseline budget has been established for the maintenance and repair of its armories. The Legislature has approved a 10-year program to eliminate the backlog of maintenance and repair that will provide an annual amount of $2 million from the State's General Fund to match a $1.5 million annual amount from the federal trust fund.

State Bar of California

With Strategic Planning Not Yet Completed, It Projects General Fund Deficits and Needs Continued Improvement in Program Administration

REPORT NUMBER 2007-030, APRIL 2007

State Bar of California's response as of October 2007, January 2008

The State Bar of California (State Bar), established by the California State Constitution, is a public corporation with a mission to preserve and protect the justice system. The law requires every person admitted and licensed to practice law in a court in California to be a member unless the individual serves as judge in a court of record. The State Bar's 23-member board of governors (board) establishes policy and guides such functions as licensing attorneys providing programs to promote the professional growth of members of the State Bar.

State law requires the Bureau of State Audits to audit the State Bar's operations from January 1, 2006, through December 31, 2006, but does not specify topics the audit should address. For this audit we reviewed the implementation of the State Bar's long-range strategic plan, its financial forecasts of expected revenues and expenditures, its administration of the Legal Services Trust Fund Program (legal services program), and its implementation of the recommendations from our 2005 audit. The 2005 audit assessed how the State Bar monitored its disciplinary case backlog, followed procedures for processing disciplinary cases, prioritized cost recovery efforts, and updated forecasts of revenues and expenditures.

Finding #1: The State Bar has not fully implemented its strategic-planning process.

In 2001 the State Bar's board began developing and implementing a strategic management cycle to guide the State Bar's activities. As part of that process, the board developed the State Bar's long-range strategic plan. As an outgrowth of the board's planning activities, the State Bar's staff engaged in a departmental strategic-planning process intended to enhance operations and build a culture of continuous improvement in the State Bar. Although the board adopted the strategic plan in 2004, the State Bar still has not completed its strategic-planning process. Specifically, the State Bar has not fully developed planning documents for each of its departments that are intended to implement the board's strategic goals and specify the indicators needed to measure departmental performance in meeting those goals. These departmental plans were to include annually updated action plans intended to identify the actions necessary to meet strategic goals and prioritize the allocation of resources.

The State Bar completed the preliminary departmental plans by December 2005. The executive director instructed each of the departments to include all ideas and comments from staff in its operational plans recognizing that the plans would require edit and revision. The State Bar expected to finalize the plans during 2006. However, according to the State Bar's executive director, several

Audit Highlights . . .

Our review revealed that the State Bar of California:

- *Began a strategic planning process in 2003; however, development of many departmental plans and performance measures are incomplete.*
- *Does not prepare annual budgets based on the results of strategic planning, but rather on projected costs for current levels of staff and resources.*
- *Is pursuing an increase in annual membership fees from active members to offset a projected deficit of almost $12 million in its general fund by December 2010.*
- *Continues to await approval of additional authority to collect money related to disciplinary cases, but does not expect the new authority to significantly increase collections in the short term.*
- *Needs to improve administration of its Legal Services Trust Fund Program to ensure that it maximizes revenue from interest on trust accounts attorneys establish and appropriately completes required monitoring activities.*
- *Reduced its backlog of open disciplinary cases to 256 cases, moving closer to its goal of 200 backlogged cases.*
- *Needs to continue improving its processing of disciplinary cases by consistently using checklists and conducting random audits.*

challenges, such as reorganization of several departments and the retirement of three key senior executives, have slowed the revision process. The State Bar currently expects to complete the revisions to the departmental plans by July 2007.

In addition, the State Bar has begun to evaluate its information technology systems and is concerned that they may not be capable of effectively capturing performance measurement data identified in the departmental plans. The State Bar estimates the cost to upgrade its information technology systems will total $3.4 million to $5.8 million per year from 2008 to 2013; however, it has not yet identified a source of funds to pay for these upgrades.

Further, because its strategic-planning efforts are still incomplete, the State Bar has not been able to determine whether it is accomplishing the board's strategic goals and does not currently tie its annual budget to its strategic plan and performance measurement efforts. Rather, the State Bar's budget process focuses primarily on estimating the cost of current staff and other resources using known and anticipated price increases.

To ensure that the strategic plan is fully implemented in an effective and timely manner, we recommended that the State Bar do the following:

- Complete revisions of the departmental plans that will serve to implement the board's strategic goals and ensure that each departmental plan contains meaningful performance indicators that will measure how successfully goals are being met.
- Limit performance measurement to indicators that can be accurately tracked on an ongoing basis and measure desired outcomes.
- Ensure that its departments, during their departmental plan revision process, identify the objectives and performance measures that can be attained, considering existing resource levels and information technology capabilities. In addition, on an ongoing basis the departments should revise their annual action plans to update this information given additional information technology upgrades.
- Take the steps necessary to ensure its information technology systems can capture the required performance measurement data to support the projects needed to accomplish strategic-planning objectives, or devise alternative means of capturing this data such as using an Excel spreadsheet.

State Bar's Action: Partial corrective action taken.

The State Bar made revisions to the 14 departmental plans, as of April 30, 2007. The State Bar indicated that, going forward, its departments will submit a report of accomplishments and performance measure adjustments and proposed action plans in January or February each year.

In addition, as part of the overall review of departmental plans the State Bar has evaluated the usefulness, validity, and source of data and collection strategies for the performance measures. The State Bar has reviewed all departmental plans to determine whether the measures can be captured with the State Bar's existing technology.

Moreover, the State Bar stated that their information technology department is working on a strategy that will ensure that the systems that run the various business functions of the State Bar are modernized, sustainable, and capable of capturing and reporting relevant performance data. This plan is part of an overall agencywide plan to refresh its information technology capabilities that the State Bar anticipates will be funded in part by a $10 technology assessment to the members.

Finding #2: The State Bar projects deficits in its general fund.

Because it estimates the fees it will collect from the increased volume of membership will not keep pace with its rising costs, the State Bar forecasts it will face a deficit of nearly $12 million in its general fund by December 31, 2010. The State Bar uses its general fund to account for membership fee payments and revenues it receives that are not related to other fund activities and to account for the expenses for maintaining, operating, and supporting its attorney disciplinary process. The State Bar established its Public Protection Reserve Fund (reserve fund) in 2001 to set aside a portion of its general fund as a buffer in the event of a revenue shortfall, like that which occurred after 1997 when it was unable to obtain timely statutory authority to assess the base annual membership fee that funds its disciplinary function and other operations it pays for from its general fund. However, use of the reserve fund to mitigate the projected general fund deficit will not likely provide a satisfactory solution to the State Bar's projected imbalance between revenues and expenses in its general fund. It estimates that even if it uses the balance of the reserve fund to partially offset the projected deficit in its general fund, the combined balance in the two funds will still result in a deficit of about $6.3 million by December 31, 2010.

The State Bar's authority to assess a base annual membership fee is temporary, and historically the State Bar has needed the Legislature to reaffirm that authority every one to two years. Its current authority expires on January 1, 2008, unless extended before that date. The State Bar noted that to remedy the expected deficit, it is in ongoing discussions with key members of the Legislature to obtain statutory authority to increase the base annual membership fee for active members. The State Bar has determined it will need a $25 increase in the fee to eliminate its projected general fund deficit and provide funding for information technology upgrades. However, as previously discussed, it has not successfully completed its strategic planning process that will allow it to identify the resources it needs to meet its strategic goals and base its budgeting process on these identified resources. This fact could hamper its efforts to justify a fee increase.

In addition, the State Bar does not anticipate that pending approval by the California Supreme Court (supreme court) of procedures to help recover its costs to discipline members or recover payments to members' clients from the Client Security Fund will have an immediate significant impact. This new enhanced collection authority, when implemented, will allow the State Bar to use money judgment authority to attempt to collect costs from disciplined attorneys.

The State Bar is preparing to implement its enhanced collection authority when approved. According to the State Bar's chief financial officer, in anticipation of the supreme court's approval, the State Bar is attempting to organize available information regarding the unpaid amounts. For example, the State Bar is trying to find the most current addresses of debtors and merge that information with other pertinent data, such as case numbers, restitution orders, and amounts owed. In addition, the State Bar is formulating a policy to guide staff in determining which cases will be affected by the rule, and therefore should be pursued, and which cases will be most fruitful in terms of potential collections.

However, the State Bar does not expect that its current collection rate will increase appreciably in the near future. According to the State Bar's assistant chief general counsel, the disciplined attorneys whose debts make up most of the unpaid amount were disbarred or resigned with disciplinary charges pending. He stated these attorneys are generally financially distressed and unable to repay clients or the State Bar at the time of their disbarment or resignation. The chief assistant general counsel further stated that, according to the State Bar's outside counsel. In five to 10 years some of the disciplined attorneys will have sufficient earnings to seek loans and will want to reestablish their credit and disbarred attorneys may want to seek reinstatement to practice law. He noted that credit-reporting agencies would pick up abstracts of judgments that have been recorded in county recorders' offices, but that if the State Bar wanted to directly report the debts, it would need procedures to comply with the federal Fair Credit Reporting Act. The chief assistant general counsel stated that the State Bar is still considering the costs and benefits of reporting judgments to credit-reporting agencies.

Additionally, although the law currently assesses a yearly $10 per-member building fee, which the State Bar is accumulating in its building fund, it can only use those funds to acquire and improve facilities or other related capital expenditures. The State Bar anticipates accumulating the funds over the next seven years in anticipation of using the balance as part of a down payment for the purchase of a facility in Los Angeles.

To effectively allocate its resources and justify its membership fees we recommended that the State Bar align its budgets with the results of its strategic-planning process.

To ensure that it maximizes collection efforts and its ability to implement the Rules of Court as soon as the supreme court approves procedures allowing their use, we recommended that the State Bar do the following:

- Complete its database and input all available information on the Client Security Fund and disciplinary debtors.
- Implement its proposed policy for pursuing debtors.
- Complete its assessment of the costs and benefits of reporting judgments to credit-reporting agencies.

State Bar's Action: Partial corrective action taken.

To ensure the highest level of integrity in its automated system, the State Bar has contracted with an independent auditor to review current procedures and processes to ensure that judgments filed are accurate and the data has integrity as information moves through the system.

The supreme court approved the Rule of Court in April 2007. In July 2007 the board adopted a pursuit policy for court ordered disciplinary costs and Client Security Fund obligations, which was immediately implemented. The State Bar reported that, as of January 2008, it has been awarded 80 judgments.

The State Bar interviewed three collection agencies currently under contract with the Administrative Office of the Courts and submitted to the vendors a request for additional information and pricing to assure they can evaluate the costs and benefits of using some or all of the collection agencies' services. The State Bar has tentatively selected one of the vendors.

The State Bar's 2008 adopted budget has been redesigned to link its budget with its strategic planning process. The proposed budget is aligned with the State Bar's organizational and functional structures as defined by its strategic plan and presents basic workload and performance information in major program areas.

Finding #3: The State Bar needs to improve its legal services program and attorney discipline system.

For grant year 2006–07 the State Bar awarded $26.7 million in grant funds from the legal services program to provide civil legal assistance to indigent Californians. The funds for the program come primarily from interest on trust accounts attorneys establish for certain client funds, state budget appropriations, and an allocation of certain court filing fees. The State Bar does not ensure that all attorneys comply with the law requiring them to remit the interest on these trust accounts to the State Bar to support the legal services program. The State Bar reported that in 2006 it received about $15.8 million from attorneys' trust accounts. However, because about 25 percent of the practicing attorneys in California do not remit interest earned on clients' trust accounts that qualify for the legal services program or report that they do not maintain trust accounts, the State Bar does not know whether it receives all the funds it should to support the legal services program.

The State Bar asks attorneys to report when they open or close trust accounts or no longer handle such client funds; however, it does not investigate nonreporting attorneys to determine whether they should establish trust accounts and remit the interest to the State Bar. According to the State Bar's deputy executive director, the State Bar has no authority to mandate reporting and would need an amendment to the statutes or to the Rules of Court to gain the authority to mandate reporting from its members.

Additionally, the State Bar is responsible for on-site monitoring of grantees to determine whether they complied with the program's requirements. However, it does not always adequately perform or document monitoring reviews of the legal services program grantees. Despite the State Bar's grantee-monitoring visits scheduled for the three-year period from January 1, 2004, through December 31, 2006, 12 grantees did not receive program-monitoring visits, and 51 did not receive fiscal-monitoring visits. Further, the State Bar does not always retain documentation needed to demonstrate that staff have completed all the steps in the monitoring process.

A 2005 Bureau of State Audits' report assessed the efforts of the State Bar to address the backlog of disciplinary cases it began accumulating after temporarily losing its statutory authority in 1997 to assess a base annual membership fee. In 2005 the State Bar had 315 backlogged disciplinary cases. As of December 2006 the State Bar had reduced the backlog to 256 with the oldest cases dating back to 2003. This progress moved the State Bar closer to its goal of having no more than 200 backlogged cases.

Our 2005 audit also addressed the State Bar's inability to process disciplinary cases efficiently. In response, the State Bar created checklists to ensure that staff follow significant processing steps and developed random audit procedures to improve its oversight of the processing of disciplinary cases. However, the State Bar has not fully implemented either of these policies. Three of the 30 files we reviewed did not contain properly completed checklists, and supervising trial counsels who oversee the disciplinary case investigators do not always perform the random audits required by the State Bar's policy.

To ensure that it receives all the trust account interest income available for its legal services program, we recommended that the State Bar consider conducting activities, such as interviewing or surveying a sample of members who do not report whether they have established trust accounts. This would allow the State Bar to determine whether some members are holding clients' funds without establishing trust accounts and remitting the interest to the State Bar. If the State Bar finds that the nonreporting members do, in fact, hold client funds that are nominal in amount or are held for a short period of time, it should seek the authority to enforce compliance reporting.

To properly monitor recipients of grants under its legal services program, the State Bar should ensure that it performs and documents all required monitoring reviews; in addition, it should develop a plan to perform the fiscal on-site monitoring visits that were not performed while staying current with its ongoing monitoring requirements.

The State Bar should continue its efforts to reduce its backlog of disciplinary cases to reach its goal of having no more than 200 cases.

The State Bar should ensure that staff use checklists of significant tasks when processing case files and fully implement its 2005 policy directive for random audits of case files by supervising trial counsel.

State Bar's Action: Partial corrective action taken.

The State Bar transmitted to the supreme court for approval a proposal that would require each attorney to complete and maintain an online registration. If adopted by the supreme court, proposed Rule 9.8 specifically requires lawyers to report whether the attorney or the attorney's law firm has established and maintained one or more trust fund accounts required under Business and Professions Code, Section 6211.

The State Bar has decided to focus upon addressing the bigger solution through adoption of online reporting in lieu of undertaking the interim step of manually polling members to determine whether non-reporting members have trust fund accounts.

The State Bar stated that it is coordinating with the Administrative Office of the Courts to survey other grant-making organizations to assist in establishing best practices for monitoring processes and tools. The State Bar's legal services program staff brought monitoring visits current as of December 31, 2007.

Moreover, the State Bar's Office of the Chief Trial Counsel modified its department plan in May 2007 to, among other things, establish a revised goal of having no more than 250 open backlog cases at the end of each year, rather than the previous goal of 200 open backlog cases. Given staffing constraints, the State Bar feels that it may be difficult to achieve the revised backlog goal of 250 by the end of 2007.

Lastly, the State Bar's Chief Trial Counsel issued a memorandum to all affected staff reminding them to use the checklists and directs appropriate supervisory personnel to perform random audits on a monthly basis with respect to the open investigation files of investigators assigned to original disciplinary investigations. The memorandum also directs supervisory personnel to adequately document the random audits and to confirm that any necessary corrective action has been taken.

California Department of Transportation

Although Encouraging Contractors to Use Recycled Materials in Its Highway Projects, Caltrans Collects Scant Data on Its Recycling and Solid Waste Diversion Efforts

REPORT NUMBER 2005-135, JULY 2006

California Department of Transportation's response as of June 2007

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to evaluate the California Department of Transportation's (Caltrans) compliance with the California Public Resources Code, Section 42701, which requires it to write contracts so construction contractors can use recycled materials, unless its director determines that using such materials is not cost-effective. The audit committee also asked us to assess the process Caltrans uses to determine the cost-effectiveness of using recycled materials. Further, we were asked to identify any impediments to Caltrans' use of recycled aggregate material. In addition, the audit committee asked the bureau to determine the extent to which Caltrans communicates the State's recycling requirements to its contractors and encourages them to use recycled materials in its construction projects. Lastly, the audit committee asked us to determine whether Caltrans maintains data on how much recycled aggregate base material its contractors use. If Caltrans does not track this information, the committee asked the bureau to identify, to the extent feasible and using available data, the amount of recycled material used by a sample of Caltrans' geographically diverse road construction and repair projects, both small and large, over the last five years.

Finding #1: Neither Caltrans nor the Public Resources Code requires contractors to report how much recycled aggregate they use in highway construction projects.

Although it encourages contractors to use recycled aggregate in its construction projects, Caltrans does not track how much recycled material contractors actually use for highway construction. Caltrans gives contractors the option to use up to 100 percent recycled aggregate and does not generally perceive any impediments to using such material as long as it meets Caltrans' established standards. However, contractors do not report data on how much recycled aggregate they actually use in highway projects, because statutes do not require and Caltrans does not ask contractors to submit such information. As a result, Caltrans lacks complete data on how much recycled aggregate contractors use. Nevertheless, to comply with statutes requiring it to limit the solid waste disposed of in landfills, Caltrans does collect some data on the amount of highway construction waste, primarily asphalt and concrete, its contractors recycle.

Audit Highlights . . .

Our review of the California Department of Transportation's (Caltrans) use of recycled aggregate in its highway construction projects found that:

» *Although Caltrans does not generally see any impediments to using recycled aggregate in its construction projects and allows its contractors to use up to 100 percent recycled materials, it allows contractors to decide when and to what extent recycled aggregate is more cost-effective than virgin aggregate.*

» *With no statutory requirement to report how much recycled aggregate is used, Caltrans does not collect this data and thus does not know how much recycled materials its contractors use in highway construction projects.*

» *To demonstrate compliance with 1999 legislation, Caltrans captures and reports some data on how much waste construction material its contractors generate for highway construction projects and divert away from landfills.*

» *Caltrans did not report the solid waste generated on all its construction projects and often could not support the data it did report.*

Finding #2: Caltrans cannot demonstrate that it is meeting the State's goals for diverting solid waste.

Caltrans cannot be sure that it is meeting state goals for diverting solid waste from landfills because the data it collects and reports to the California Integrated Waste Management Board (board) are incomplete and unsupported. Our review of Caltrans' annual reports on its efforts to divert construction waste materials found that between January 2002 and December 2004 the reports accounted for only a few of the several hundred projects that were active during those years. Although based on more projects than in prior years, Caltrans' 2005 reports to the board contained data for only 14 percent of the projects that should have been included in those reports. Also, the annual reports' project data—collected from the Solid Waste Disposal and Recycling Reports (diversion forms)—are not reliable. In particular, 24 of the 28 diversion forms that were available to us, out of our sample of 30 contracts, contained obvious errors or were not signed by resident engineers. Taking into account these omissions and errors, it is unclear whether Caltrans is meeting state goals for diverting at least 50 percent of its solid waste from landfills.

To ensure that its annual waste management reports to the board are complete and supported, we recommended that Caltrans ensure that its contractors for all projects annually submit diversion forms to the projects' resident engineers in a timely fashion and that its resident engineers submit a copy of all reviewed diversion forms to the appropriate recycling coordinator in a timely fashion. In addition, we recommended that Caltrans ensure that its resident engineers consistently review and sign all diversion forms and consistently follow up with contractors to resolve any discrepancies in material type or volume.

Caltrans' Action: Corrective action taken.

Through issuance of a construction policy bulletin, revisions to its construction manual, and development of a new recycling form, Caltrans has finalized guidance procedures for its district recycling coordinators to improve data collection and submission and to clarify reporting requirements. In addition, Caltrans has developed a training module for resident engineers on the updated procedures, which it plans to include in the resident engineers' winter 2007 training. Lastly, Caltrans noted that it will perform an evaluation in January 2008 to determine if its changes have improved the quantity and quality of its data collection and reporting.

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

REPORT NUMBER 2005-119, FEBRUARY 2006

Department of Industrial Relations' and the California Department of Transportation's responses as of April 2007

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.

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.*

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 is impractical 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 find evidence that violations occurred. 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. Rather, the division indicates it is working with another division within the department 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 workplaces most likely to cause death or serious injury to workers.

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.