

# CALIFORNIA STATE AUDITOR

Bureau of State Audits

## Implementation of State Auditor's Recommendations

Audits Released in January 2011 Through December 2012

Special Report to  
*Assembly Budget Subcommittee #4—State Administration*



February 2013 Report 2013-406 A4

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# CALIFORNIA STATE AUDITOR

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February 28, 2013

2013-406 A4

The Honorable Tom Daly, Chair  
Assembly Budget Subcommittee No. 4  
State Capitol  
Sacramento, California 95814

Dear Assemblymember Daly:

The California State Auditor presents this special report for the Assembly Budget Subcommittee No. 4—State Administration. The report summarizes the audits and investigations we issued during the previous two years that are within this subcommittee's purview. Additionally, the report includes the major findings and recommendations, along with the corrective actions entities reportedly have taken to implement our recommendations. To facilitate the use of the report, we have included a table that summarizes the status of each entity's implementation efforts based on its most recent response.

This information is also available in a special report that is organized by policy areas that summarizes all audits and investigations we issued from January 2011 through December 2012. The special policy area report includes a table that identifies monetary values that entities could realize if they implemented our recommendations, and is available on our Web site at [www.auditor.ca.gov](http://www.auditor.ca.gov).

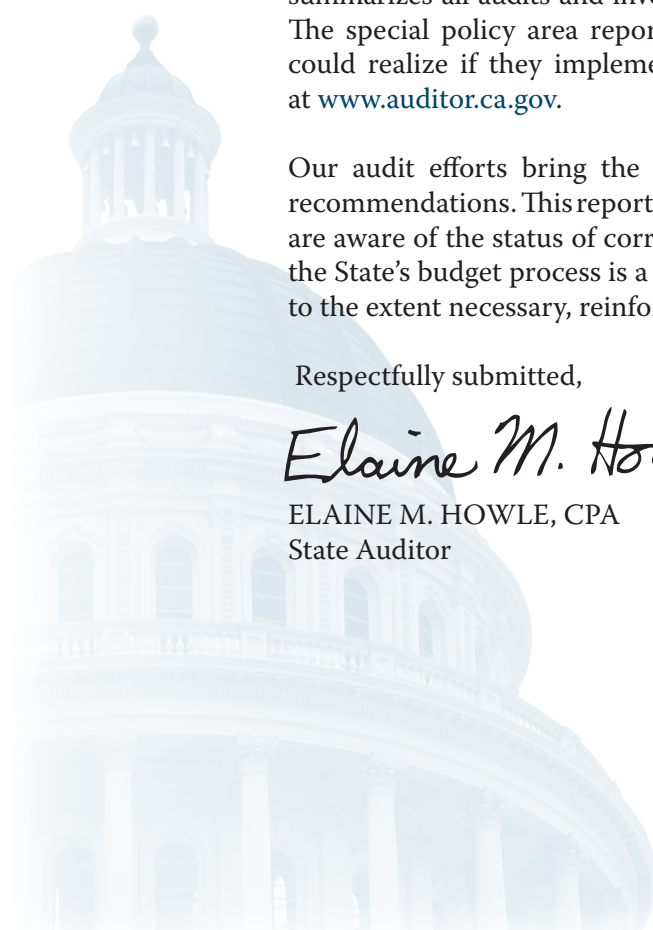
Our audit efforts bring the greatest returns when the entity acts upon our findings and recommendations. This report is one vehicle to ensure that the State's policy makers and managers are aware of the status of corrective action entities report they have taken. Further, we believe the State's budget 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, CPA  
State Auditor





# Contents

## Introduction

## Table

<i>Recommendation Status Summary</i>	1
--------------------------------------	---

## Amador County

<b>Report Number 2010-036, Indian Gaming Special Distribution Fund: Local Governments Continue to Have Difficulty Justifying Distribution Fund Grants</b>	5
---	---

## California Health Facilities Financing Authority

<b>Report Number 2011-118 / 2011-613, Conduit Bond Issuers: Issuers Complied With Key Bond Requirements, but Two Joint Powers Authorities' Compensation Models Raise Conflict-of-Interest Concerns</b>	11
--	----

<b>Report Number 2012-042, Children's Hospital Program: Fund Disbursements Are Appropriate, but Estimates of Cash Needs Have Been Consistently High</b>	15
---	----

## California Housing Finance Agency

<b>Report Number 2010-123, California Housing Finance Agency: Most Indicators Point to Continued Solvency Despite Its Financial Difficulties Created, in Part, by Its Past Decisions</b>	17
--	----

## California Labor and Workforce Development Agency

<b>Report Number 2011-111, Federal Workforce Investment Act: More Effective State Planning and Oversight Is Necessary to Better Help California's Job Seekers Find Employment</b>	19
---	----

## California Municipal Finance Authority

<b>Report Number 2011-118 / 2011-613, Conduit Bond Issuers: Issuers Complied With Key Bond Requirements, but Two Joint Powers Authorities' Compensation Models Raise Conflict-of-Interest Concerns (see summary on page 11)</b>	
---	--

**California Statewide Communities Development Authority**

**Report Number 2011-118 / 2011-613, Conduit Bond Issuers: Issuers Complied With Key Bond Requirements, but Two Joint Powers Authorities' Compensation Models Raise Conflict-of-Interest Concerns**  
(see summary on page 11)

**California Technology Agency**

**Report Number 2010-112, Employment Development Department: Its Unemployment Program Has Struggled to Effectively Serve California's Unemployed in the Face of Significant Workload and Fiscal Challenges** 23

**California Workforce Investment Board**

**Report Number 2011-111, Federal Workforce Investment Act: More Effective State Planning and Oversight Is Necessary to Better Help California's Job Seekers Find Employment**  
(see summary on page 19)

**City of San José**

**Report Number 2012-106, City of San José: Some Retirement Cost Projections Were Unsupported Although Rising Retirement Costs Have Led to Reduced City Services** 27

**City of Vernon**

**Report Number 2011-131, City of Vernon: Although Reform Is Ongoing, Past Poor Decision Making Threatens Its Financial Stability** 29

**Department of Consumer Affairs**

**Report Number 2011-119, Physical Therapy Board of California: Although It Can Make Improvements, It Generally Processes Complaints and Monitors Conflict-of-Interest Requirements Appropriately** 39

**Report Number I2012-1, Investigations of Improper Activities by State Agencies and Employees: Bribery, Conspiracy to Commit Mail Fraud, Improper Overtime Payments, Improper Use of Lease Proceeds, Improper Travel Expenses, and Other Violations of State Law, April 2011 Through June 2012**

**Allegation [I2009-1341]** 41

**Department of Finance**

**Report Number 2010-117, General Obligation Bonds:** *The Departments of Water Resources and Finance Should Do More to Improve Their Oversight of Bond Expenditures* 43

**Report Number 2012-037, Department of Housing and Community Development:** *Awards of Housing Bond Funds Are Appropriate, but Cash Balances Are High and Monitoring Continues to Need Improvement* 47

**Department of Food and Agriculture**

**Report Number 2011-106, Intellectual Property:** *An Effective Policy Would Educate State Agencies and Take Into Account How Their Functions and Property Differ* 51

**Department of General Services**

**Report Number 2011-116.1, Department of General Services:** *The Division of the State Architect Lacks Enforcement Authority and Has Weak Oversight Procedures, Increasing the Risk That School Construction Projects May Be Unsafe* 55

**Report Number 2011-116.2, Department of General Services:** *Strengthening the Division of the State Architect's Workload Management and Performance Measurements Could Help It Avoid Delays in Processing Future Increases in Workload* 61

**Report Number 2011-120, California Department of Transportation:** *Its Poor Management of State Route 710 Extension Project Properties Costs the State Millions of Dollars Annually, Yet State Law Limits the Potential Income From Selling the Properties* 65

**Report Number 2011-504, High-Speed Rail Authority Follow-Up:** *Although the Authority Addressed Some of Our Prior Concerns, Its Funding Situation Has Become Increasingly Risky and the Authority's Weak Oversight Persists* 77

**Report Number I2010-2, Investigations of Improper Activities by State Employees:** *Delay in Reassigning an Incompetent Psychiatrist, Misuse of State Resources, Failure to Protect the Security of Confidential Documents, Theft of Registration Fees, and Other Violations of State Law, January 2011 Through June 2011*

**Allegation [I2008-1024]** 85

**Department of Housing and Community Development**

**Report Number 2012-037, Department of Housing and Community Development: Awards of Housing Bond Funds Are Appropriate, but Cash Balances Are High and Monitoring Continues to Need Improvement**  
(see summary on page 47)

**Department of Industrial Relations**

**Report Number I2011-1, Investigations of Improper Activities by State Agencies and Employees: Waste of State Funds, Misuse of State Resources, Falsification of Records, Inexcusable Neglect of Duty, Failure to Monitor Time Reporting, and Other Violations of State Law, July 2010 Through March 2011**

Allegation [I2008-0902]

87

**Employment Development Department**

**Report Number 2010-112, Employment Development Department: Its Unemployment Program Has Struggled to Effectively Serve California's Unemployed in the Face of Significant Workload and Fiscal Challenges**  
(see summary on page 23)

**Report Number 2011-111, Federal Workforce Investment Act: More Effective State Planning and Oversight Is Necessary to Better Help California's Job Seekers Find Employment**  
(see summary on page 19)

**Report Number I2012-1, Investigations of Improper Activities by State Agencies and Employees: Bribery, Conspiracy to Commit Mail Fraud, Improper Overtime Payments, Improper Use of Lease Proceeds, Improper Travel Expenses, and Other Violations of State Law, April 2011 Through June 2012**

Allegation [I2008-1217]

89

**Fair Political Practices Commission**

**Report Number 2011-118 / 2011-613, Conduit Bond Issuers: Issuers Complied With Key Bond Requirements, but Two Joint Powers Authorities' Compensation Models Raise Conflict-of-Interest Concerns**  
(see summary on page 11)



## Franchise Tax Board

**Report Number I2012-1, Investigations of Improper Activities by State Agencies and Employees: Bribery, Conspiracy to Commit Mail Fraud, Improper Overtime Payments, Improper Use of Lease Proceeds, Improper Travel Expenses, and Other Violations of State Law, April 2011 Through June 2012**

**Allegation [I2009-0634]** 91

## Humboldt County

**Report Number 2010-036, Indian Gaming Special Distribution Fund: Local Governments Continue to Have Difficulty Justifying Distribution Fund Grants (see summary on page 5)**

## Los Angeles County

**Report Number 2011-121, Probationers' Domestic Violence Payments: Improved Processes for Managing and Distributing These Payments Could Increase Support for Local Shelters** 93

## Los Angeles County Department of Children and Family Services

**Report Number 2011-101.2, Los Angeles County Department of Children and Family Services: Management Instability Hampered Efforts to Better Protect Children** 101

## Office of the Secretary of State

**Report Number I2012-1, Investigations of Improper Activities by State Agencies and Employees: Bribery, Conspiracy to Commit Mail Fraud, Improper Overtime Payments, Improper Use of Lease Proceeds, Improper Travel Expenses, and Other Violations of State Law, April 2011 Through June 2012**

**Allegation [I2009-0634]**  
(see summary on page 91)

## Physical Therapy Board of California

**Report Number 2011-119, Physical Therapy Board of California: Although It Can Make Improvements, It Generally Processes Complaints and Monitors Conflict-of-Interest Requirements Appropriately (see summary on page 39)**

**Riverside County**

**Report Number 2010-036, Indian Gaming Special Distribution Fund:** *Local Governments Continue to Have Difficulty Justifying Distribution Fund Grants*  
(see summary on page 5)

**Sacramento County**

**Report Number 2011-121, Probationers' Domestic Violence Payments:** *Improved Processes for Managing and Distributing These Payments Could Increase Support for Local Shelters*  
(see summary on page 93)

**Salinas Valley Memorial Healthcare System**

**Report Number 2011-113, Salinas Valley Memorial Healthcare System:** *Increased Transparency and Stronger Controls Are Necessary as It Focuses on Improving Its Financial Situation* 105

**San Diego County**

**Report Number 2010-036, Indian Gaming Special Distribution Fund:** *Local Governments Continue to Have Difficulty Justifying Distribution Fund Grants*  
(see summary on page 5)

**Report Number 2011-121, Probationers' Domestic Violence Payments:** *Improved Processes for Managing and Distributing These Payments Could Increase Support for Local Shelters*  
(see summary on page 93)

**Santa Barbara County**

**Report Number 2010-036, Indian Gaming Special Distribution Fund:** *Local Governments Continue to Have Difficulty Justifying Distribution Fund Grants*  
(see summary on page 5)

**Santa Clara County**

**Report Number 2011-121, Probationers' Domestic Violence Payments:** *Improved Processes for Managing and Distributing These Payments Could Increase Support for Local Shelters*  
(see summary on page 93)

**Shasta County**

**Report Number 2010-036, Indian Gaming Special Distribution Fund: *Local Governments Continue to Have Difficulty Justifying Distribution Fund Grants***  
(see summary on page 5)

**State Controller's Office**

**Report Number I2011-1, Investigations of Improper Activities by State Agencies and Employees: *Waste of State Funds, Misuse of State Resources, Falsification of Records, Inexcusable Neglect of Duty, Failure to Monitor Time Reporting, and Other Violations of State Law, July 2010 Through March 2011***

**Allegation [I2009-1476]**


111

**Yolo County**

**Report Number 2010-036, Indian Gaming Special Distribution Fund: *Local Governments Continue to Have Difficulty Justifying Distribution Fund Grants***  
(see summary on page 5)



## Introduction





This report summarizes the major recommendations from audit and investigative reports we issued from January 2011 through December 2012 that relate to agencies and department 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 entities have taken in response to our findings and recommendations. We have placed this symbol  in the margin of the entity’s action to identify areas of concern or issues that we believe have not been adequately addressed.

For this report we have relied upon periodic written responses prepared by entities to determine whether corrective action has been taken. The California State Auditor’s (state auditor) policy requests that the entity provide a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow up, state law requires the entities to provide updates on their implementation of audit recommendations. The state auditor requests these updates at 60 days, six months, and one year after the public release of the audit report. However, we may request an entity to provide a response beyond on 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 entity for corrective action. These entities 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 entities. All corrective actions noted in this report were generally based on responses received by our office as of December 31, 2012. The table below summarizes the status of an entity’s implementation of our recommendations<sup>1</sup> based on its most recent response received from each one. Because an audit or investigation may cross over several departments, it may be accounted for on this table more than one time. For instance, the Federal Workforce Investment Act report is listed under the Employment Development Department, the California Workforce Investment Board, and the California Labor and Workforce Development Agency.

**Table**  
**Recommendation Status Summary**

AUDIT REPORT	FOLLOW-UP RESPONSE*				STATUS OF RECOMMENDATION				PAGE NUMBERS
	INITIAL RESPONSE	60- DAY	SIX-MONTH	ONE-YEAR	FULLY IMPLEMENTED	PARTIALLY IMPLEMENTED	PENDING	NO ACTION TAKEN	
<b>Amador County</b>									
Indian Gaming Special Distribution Fund Report 2010-036					2	2		1	5
<b>California Health Facilities Financing Authority</b>									
Conduit Bond Issuers Report 2011-118 / 2011-613					1				11
Children's Hospital Program Report 2012-042							4		15
<b>California Housing Finance Agency</b>									
Affordable Housing Solvency Report 2010-123					2				17

*continued on next page...*

<sup>1</sup> This table does not include recommendations directed to the Legislature; however, we discuss the status of legislative recommendations in the body of this report.

AUDIT REPORT	FOLLOW-UP RESPONSE*				STATUS OF RECOMMENDATION				PAGE NUMBERS	
	INITIAL RESPONSE	60-DAY	SIX-MONTH	ONE-YEAR	FULLY IMPLEMENTED	PARTIALLY IMPLEMENTED	PENDING	NO ACTION TAKEN		
<b>California Labor and Workforce Development Agency</b>										
Federal Workforce Investment Act Report 2011-111			●			1				19
<b>California Municipal Finance Authority</b>										
Conduit Bond Issuers Report 2011-118 / 2011-613		●			1		2			11
<b>California Statewide Communities Development Authority</b>										
Conduit Bond Issuers Report 2011-118 / 2011-613		●			1	1	2			11
<b>California Technology Agency</b>										
Unemployment Program Report 2010-112				●	1					23
<b>California Workforce Investment Board</b>										
Federal Workforce Investment Act Report 2011-111			●			2				19
<b>City of San José</b>										
Retirement Costs Report 2012-106		●					1			27
<b>City of Vernon</b>										
Financial Stability Report 2011-131		●			1	4	13	21		29
<b>Department of Consumer Affairs</b>										
Physical Therapy Board Report 2011-119			●			1				39
<b>Department of Finance</b>										
Housing Bonds Report 2012-037		●			1					47
Oversight of Bond Expenditures Report 2010-117				●		1		2		43
<b>Department of Food and Agriculture</b>										
Intellectual Property Report 2011-106				●	2					51
<b>Department of General Services</b>										
School Construction Projects Report 2011-116.1				●	2	10	2			55
Division of the State Architect Report 2011-116.2			●		3	3	4			61
State Route 710 Extension Properties Report 2011-120		●				10	1	4		65
High-Speed Rail Authority Follow-Up Report 2011-504			●		1					77
<b>Department of Housing and Community Development</b>										
Housing Bonds Report 2012-037		●			4	2				47
<b>Employment Development Department</b>										
Unemployment Program Report 2010-112				●	4	1		4		23
Federal Workforce Investment Act Report 2011-111			●		2		2			19
<b>Fair Political Practices Commission</b>										
Conduit Bond Issuers Report 2011-118 / 2011-613		●			1					11

AUDIT REPORT	FOLLOW-UP RESPONSE*				STATUS OF RECOMMENDATION				PAGE NUMBERS	
	INITIAL RESPONSE	60-DAY	SIX-MONTH	ONE-YEAR	FULLY IMPLEMENTED	PARTIALLY IMPLEMENTED	PENDING	NO ACTION TAKEN		
<b>Humboldt County</b>										
Indian Gaming Special Distribution Fund Report 2010-036				●				3	5	
<b>Los Angeles County</b>										
Probationers' Domestic Violence Payments Report 2011-121		●			2	1			93	
<b>Los Angeles County Department of Children and Family Services</b>										
Los Angeles County Child Welfare Services Report 2011-101.2			●		3	2	2	2	101	
<b>Physical Therapy Board of California</b>										
Physical Therapy Board Report 2011-119			●		2		1		39	
<b>Riverside County</b>										
Indian Gaming Special Distribution Fund Report 2010-036				●		1	2	1	5	
<b>Sacramento County</b>										
Probationers' Domestic Violence Payments Report 2011-121		●			3			1	93	
<b>Salinas Valley Memorial Healthcare System</b>										
Executive Compensation and Conflict of Interest Report 2011-113			●		11	3	1		105	
<b>San Diego County</b>										
Indian Gaming Special Distribution Fund Report 2010-036				●	2	1			5	
Probationers' Domestic Violence Payments Report 2011-121		●			2	2			93	
<b>Santa Barbara County</b>										
Indian Gaming Special Distribution Fund Report 2010-036				●				6	5	
<b>Santa Clara County</b>										
Probationers' Domestic Violence Payments Report 2011-121		●			1	4			93	
<b>Shasta County</b>										
Indian Gaming Special Distribution Fund Report 2010-036				●		1	2	2	5	
<b>Yolo County</b>										
Indian Gaming Special Distribution Fund Report 2010-036				●	1	1		2	5	

INVESTIGATIVE REPORT	DATE OF LAST RESPONSE	FULLY IMPLEMENTED	PARTIALLY IMPLEMENTED	PENDING	NO ACTION TAKEN	PAGE NUMBERS
<b>California State Athletic Commission</b>						
Improper Overtime Payments Investigations Report I2012-1, Allegation I2009-1341	December 2012	1		1		41
<b>Department of General Services</b>						
Misuse of State Resources Investigations Report I2010-2, Allegation I2008-1024	June 2011	2				85

continued on next page...

INVESTIGATIVE REPORT	DATE OF LAST RESPONSE	STATUS OF RECOMMENDATION				PAGE NUMBERS
		FULLY IMPLEMENTED	PARTIALLY IMPLEMENTED	PENDING	NO ACTION TAKEN	
<b>Department of Industrial Relations</b>						
Failure to Monitor Adequately Employee's Time Reporting Investigations Report I2011-1, Allegation I2008-0902	September 2011	1				87
<b>Employment Development Department</b>						
Conspiracy to Commit Mail Fraud Investigations Report I2012-1, Allegation I2008-1217	October 2012	1				89
<b>State Controller's Office</b>						
Failure to Report Absences, Failure to Monitor Adequately an Employee's Time Reporting Investigations Report I2011-1, Allegation I2009-1476	September 2011	3				111

\* For audits issued between January 1, 2011, and October 31, 2011, this table generally reflects the agencies' one-year response. The California State Auditor's report 2012-041, *Recommendations Not Fully Implemented After One Year, the Omnibus Accountability Act of 2006*, released in January 2013, reflects these agencies' subsequent responses.



# Indian Gaming Special Distribution Fund

## Local Governments Continue to Have Difficulty Justifying Distribution Fund Grants

### REPORT NUMBER 2010-036, ISSUED FEBRUARY 2011

This report, our second review of the allocation and expenditure of grants from the Indian Gaming Special Distribution Fund (distribution fund), concludes that Indian Gaming Local Community Benefit Committees (benefit committees) continue to have difficulty complying with grant requirements and related laws. Our review of a sample of 20 grants totaling \$5.7 million revealed that in 10 instances the grant recipient either could not provide evidence of, or could not quantify, the impact of the casino. As a result, they were unable to prove that the funding was in proportion to the impact of a casino, as required by law. In three other cases, benefit committees awarded grants that were unrelated or disproportionately related to casino impacts, and the Yolo County benefit committee awarded the entirety of its nearly \$336,000 allocation to an ineligible entity. Further, in three of the counties we reviewed, benefit committees did not award some cities and counties the minimum amounts the law set aside for them.

In our review of the allocation of funds to counties by the State Controller's Office, we found that the formula established in law does not take into account the possibility of a change during the course of a year in the number of devices operated by a tribe. Had the law taken into account changes due to compact amendments that took effect during fiscal year 2007–08, approximately \$2 million would have been distributed differently, providing some counties with more money and others with less. We also found that many tribes with compact amendments are negotiating agreements with local governments to directly fund mitigation projects, as required by their most recent compact terms. Finally, changes in contribution requirements due to amended compacts, as well as changes in the number of licenses, have altered the revenue streams of both the distribution fund and the Indian Gaming Revenue Sharing Trust Fund.

In the report, the California State Auditor (state auditor) made the following recommendations to the recipient counties of the distribution fund. The state auditor's determination regarding the current status of recommendations is generally based on the recipient counties responses to the state auditor as of February 2012. Please note that because not all recommendations or parts of recommendations applied to all seven of the counties we visited, the following recommendations will not always include responses from all audited entities.

#### **Recommendation 1.1—See pages 21—25 and 28 of the audit report for information on the related finding.**

The Legislature should consider amending the law to prohibit projects that are unrelated to casino impacts or are not proportionally related to casino impacts. The amendment should require that counties forfeit equivalent amounts of future money from the distribution fund if their benefit committees approve grant applications that fail to provide evidence that projects are funded in proportion to casinos' impacts.

#### ***Legislative Action: Legislation proposed.***

Assembly Bill 2515 (as amended March 29, 2012) of the 2011–2012 Regular Legislative Session, would among other things, require grant applications to clearly show how the grant will mitigate the impact of the casino on the grant applicant agency and require benefit committees to adopt a conflict-of-interest code.

**Recommendation 1.2—See pages 25—27 of the audit report for information on the related finding.**

To make certain that the projects' eligibility, merit, and relevance are discussed in a public forum during the projects' selection, the Legislature should also clarify that benefit committees should meet to consider applications before submitting them for tribal sponsorship. Alternatively, the Legislature could emphasize local priorities by amending the law to allow benefit committees to approve any applications that are submitted to them for public debate and committee approval before tribal sponsorship, regardless of the proportionality of a casino's impact.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 1.3—See pages 28—30 of the audit report for information on the related finding.**

To provide an incentive for benefit committees to award cities and counties the amounts that the Legislature has appropriated to them for mitigating casino impacts, the Legislature should require that grant funds allocated for each city and county according to the nexus test revert to the distribution fund if they are not awarded to that city or county.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 1.4.a—See pages 21—25 of the audit report for information on the related finding.**

To help ensure that they meet the grant requirements established in the California Government Code, counties should require that the county auditor review each grant application to ensure a rigorous analysis of a casino's impact and of the proportion of funding for the project provided by the grant. Benefit committees should consider a grant application only when the county auditor certifies that the applicant has quantified the impact of the casino and verifies that the grant funds requested will be proportional to the casino's impact.

***Amador County's Action: No action taken.***

- ➔ The county did not address this recommendation in its response.

***Humboldt County's Action: No action taken.***

- ➔ Humboldt County did not respond to our requests for a six-month response, nor did the county submit a one-year response.

***Riverside County's Action: Pending.***

The county stated that in Riverside County the auditor is an elected official who neither reports to the county executive officer nor the board of supervisors. As a result, the auditor cannot be "required" to provide this assistance. The county also indicated that it will ask the auditor to participate in the fiscal year 2011–12 Special Distribution Funds grant process.

***Santa Barbara County's Action: No action taken.***

- ➔ Santa Barbara County did not respond to our requests for a six-month response, nor did the county submit a one-year response.

***San Diego County's Action: Partially implemented.***

The county stated that it continues to take this recommendation under advisement, as both the county and the benefit committee agree with the importance of a thorough review. It also indicated that instead of the county auditor reviewing every grant application, the county auditor conducted a review of the benefit committee grant process and documents. Finally, the county stated that the county auditor validated the benefit committee's methods used to quantify impacts, and did not have any suggestions to improve the request for information, but did reiterate the need for a thorough analysis of the data presented in the application during the review process. However, the county did not provide evidence to substantiate this claim.

***Shasta County's Action: Pending.***

The county stated that it continues to work with the county auditor in determining their legal responsibilities as it relates to auditing grant applications. However, the county has provided no evidence to substantiate this claim.

***Yolo County's Action: No action taken.***

The county did not address this recommendation in its response.



**Recommendation 1.4.b—See page 31 of the audit report for information on the related finding.**

To help ensure that they meet the grant requirements established in the California Government Code, counties should review the law for changes that may affect applicants' eligibility for distribution fund grants before awarding the grants so that ineligible entities do not receive grants.

***Yolo County's Action: No action taken.***

The county did not address this recommendation in its response.



**Recommendation 1.4.c—See pages 24 and 25 of the audit report for information on the related finding.**

To help ensure that they meet the grant requirements established in the California Government Code, counties should more rigorously review applications that are to be administered and spent by an entity other than the local government that applies for the funds. Specifically, benefit committees should require that each grant application clearly show how the grant will mitigate the impact of the casino on the applicant agency.

***Amador County's Action: Fully implemented.***

In April 2011 the benefit committee adopted procedures requiring eligible applicants to demonstrate how they will be able to document and quantify the impact that is being mitigated by the project. The county provided documentation demonstrating that it had implemented these procedures.

***Humboldt County's Action: No action taken.***

Humboldt County did not respond to our requests for a six-month response, nor did the county submit a one-year response.



***Riverside County's Action: No action taken.***

The county did not address this recommendation in its response.



***Santa Barbara County's Action: No action taken.***

- ➔ Santa Barbara County did not respond to our requests for a six-month response, nor did the county submit a one-year response.

***San Diego County's Action: Fully implemented.***

The county stated that the benefit committee's process is one that provides a rigorous review of the grant applications through a comprehensive, transparent, and public process. The benefit committee has established application policies, procedures, and an application form for the grants following the priorities specified in Section 12715(g) of the California Government Code. The benefit committee further confirmed that grant documents request information from applicants to ensure that metrics clearly demonstrate proportionality for impacts.

***Shasta County's Action: No action taken.***

- ➔ The county did not address this recommendation in its response.

***Yolo County's Action: Fully implemented.***

The county stated that in the benefit committee's last funding cycle, the benefit committee elected to fund three applications which clearly described the impacts of tribal gaming they were seeking to mitigate, including an analysis of proportionality where appropriate.

**Recommendation 1.4.d—See pages 28—30 of the audit report for information on the related finding.**

To help ensure that they meet the grant requirements established in the California Government Code, counties should ensure that eligible cities and counties receive the proportional share of funding they are set aside according to the nexus test by making the governments aware of available distribution fund grants and of the minimum grant amounts that are set aside for them under the nexus test.

***Amador County's Actions: Fully implemented.***

The county provided notice to each jurisdiction in the county that was eligible for funding from the distribution fund of their eligibility and the amounts set aside for them.

***Santa Barbara County's Action: No action taken.***

- ➔ Santa Barbara County did not respond to our requests for a six-month response, nor did the county submit a one-year response.

**Recommendation 1.4.e—See pages 28—30 of the audit report for information on the related finding.**

To help ensure that they meet the grant requirements established in the California Government Code, counties should encourage eligible local governments to submit multiple applications so that the benefit committees can choose appropriate projects while ensuring that local governments are awarded the amount defined in law.

***Amador County's Action: Partially implemented.***

In its six-month response, the county stated that eligible jurisdictions were encouraged to apply for multiple projects so that the benefit committee could choose projects that best mitigated the impacts addressed by the distribution funds. It further stated that as a result, many more project requests were received than could be funded. However, the county did not provide evidence to substantiate this claim, nor did the county address this recommendation in its one-year response.

***Riverside County's Action: Pending.***

The county stated that during the next request for distribution fund grant applications, eligible entities will be encouraged to submit multiple funding applications.

***Santa Barbara County's Action: No action taken.***

Santa Barbara County did not respond to our requests for a six-month response, nor did the county submit a one-year response.

***San Diego County's Action: Fully implemented.***

The county stated that it continues to broadly distribute notice to eligible local governments via email to announce the call for applications. It also indicated that it files public notice with the clerk of the board so agenda packets are posted in compliance with the Brown Act requirements. The benefit committee's frequently ask questions state that eligible agencies can submit multiple applications.

***Shasta County's Action: No action taken.***

The county did not address this recommendation in its response.

**Recommendation 1.4.f—See pages 31—34 of the audit report for information on the related finding.**

To help ensure that they meet the grant requirements established in the California Government Code, counties should require benefit committee filing officers to avail themselves of the free training provided by the Fair Political Practices Commission (FPPC) so that the filing officers are aware of and meet their responsibilities under the Political Reform Act of 1974. Counties should also adhere to FPPC guidelines for notifying filers of the need to submit statements of economic interests.

***Amador County's Action: Partially implemented.***

According to the county, in April 2011 the benefit committee adopted procedures requiring all members of the benefit committee to submit a properly completed Form 700 specifically identifying the benefit committee as required by the FPPC, and, accordingly, all members of the benefit committee filed the form. However, the county did not address all aspects of the recommendation.

***Humboldt County's Action: No action taken.***

Humboldt County did not respond to our requests for a six-month response, nor did the county submit a one-year response.

***Riverside County's Action: Partially implemented.***

The county stated that the benefit committee adopted the Standard Code of the FPPC as the Conflict-of-Interest Code, and it requires committee members to complete form 700 annually. However, the county did not provide evidence of these procedures to substantiate this claim. Further, it did not address all aspects of the recommendation.

***Santa Barbara County's Action: No action taken.***

Santa Barbara County did not respond to our requests for a six-month response, nor did the county submit a one-year response.

***Shasta County's Action: Partially implemented.***

The county stated that county filing officers notified all committee members of the requirement to submit Statement of Economic Interest forms, and as a result, all current benefit committee members have complied. However, the county did not provide evidence to substantiate this claim. Further, it did not address all aspects of the recommendation.

***Yolo County's Action: Partially implemented.***

The county stated that the filing officer for the benefit committee coordinates with the County Clerk-Recorder's Office to ensure all committee members were informed of their obligation to file statements of economic interest by the required date. However, the county did not provide evidence to substantiate this claim. Further, it did not address all aspects of the recommendation.

**Recommendation 1.4.g—See pages 32 and 33 of the audit report for information on the related finding.**

To help ensure that they meet the grant requirements established in the California Government Code, counties should ensure that benefit committees' conflict-of-interest codes comply with the political reform act by reviewing the act and their codes, and changing the codes as necessary to meet the act's requirements.

***Santa Barbara County's Action: No action taken.***

- ➡ Santa Barbara County did not respond to our requests for a six-month response, nor did the county submit a one-year response.

***Shasta County's Action: Pending.***

The county stated it is continuing to review the benefit committee conflict-of-interest code and will update it as necessary. However, the county did not provide documentation to substantiate this claim.

**Recommendation 2.1—See page 42 of the audit report for information on the related finding.**

The Legislature should amend the law for allocating distribution funds to counties to include provisions for prorating a county's distribution fund allocation based on the percentage of the year that each gaming device in the county is required to contribute to the fund. Such an amendment would ensure a more proportionate distribution when the number of contributing gaming devices changes during the course of the year.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.



## Conduit Bond Issuers

### Issuers Complied With Key Bond Requirements, but Two Joint Powers Authorities' Compensation Models Raise Conflict-of-Interest Concerns

#### REPORT NUMBER 2011-118/2011-613, ISSUED AUGUST 2012

This report concludes that it may be helpful for the Legislature or the Fair Political Practices Commission (FPPC), as appropriate, to provide clear policy direction regarding whether contingency fees paid to private employers of consultants participating in financing decisions should be permissible under California's conflict-of-interest laws. Both California Statewide Communities Development Authority (California Communities) and California Municipal Finance Authority (Municipal Finance) are staffed entirely by private consulting firms. For their work, the consulting firms receive a percentage of the fees associated with each conduit revenue bond the joint powers authorities issue. During July 2006 through June 2011, California Communities and Municipal Finance paid their consultants roughly \$50 million and \$4.6 million, respectively. These amounts represent 59 percent of total revenues generated for California Communities and 49 percent for Municipal Finance. This method of compensation raises a concern under the Political Reform Act of 1974 (political reform act), which prohibits public officials—including consultants performing the work of public officials—from making, participating in, or attempting to influence certain governmental decisions in which they have a material economic interest. In explaining why they believe the compensation model does not violate the political reform act, consultants who advise the public entities rely on an advice letter issued by the FPPC to a different entity. However, neither the FPPC nor a court of appropriate jurisdiction have considered the applicability of the reasoning set out in that advice letter to the specific circumstances described in this audit report.

The joint powers authorities' use of consultants also raises a concern under California Government Code, Section 1090 (Section 1090). This state law prohibits public officials and employees from having a financial interest in any public contract whose formation or approval they participate in, which includes the issuance of conduit revenue bonds. Although there is some case law that suggests that consultants who contract with public agencies may be paid on a contingency fee basis for their services without violating Section 1090, no court has squarely addressed the specific question presented here and we therefore cannot reach a definitive legal conclusion.

This report also concludes that the joint powers authorities could improve their contracting practices to better ensure the services they receive are reasonably priced. The boards of directors for California Communities and Municipal Finance have not required the consulting firms staffing the joint powers authorities to compete against other firms since the joint powers authorities were formed in 1988 and 2004, respectively. By not periodically bidding out the contracts for these services, the joint powers authorities have less assurance that they are getting the best value from their consultants. However, notwithstanding the potential problems described above, during 2006 through 2011 California Communities and Municipal Finance met bond issuance requirements and generally fulfilled reporting obligations, including those established in 2010 under Senate Bill 99. Similarly, the California Health Facilities Financing Authority (Health Financing Authority) also met these requirements.

In the report, the California State Auditor (state auditor) made the following recommendations to California Communities, Municipal Finance, and the Health Financing Authority. The state auditor's determination regarding the current status of recommendations is based on these agencies' responses to the state auditor as of October 2012 and additional information California Communities and Municipal Finance provided in November 2012.

**Recommendation 1.1—See pages 18—23 of the audit report for information on the related finding.**

If the Legislature believes that the compensation model is appropriate, whereby the private firms that employ consultants are paid a percentage of the fees associated with bond issuances, the Legislature should enact legislation that creates a clearly stated exemption from Section 1090. On the other hand, if the Legislature believes that this compensation model is not appropriate, it should enact legislation that clearly proscribes, or limits, such a model.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 1.2—See pages 20—23 of the audit report for information on the related finding.**

The FPPC should adopt regulations that clarify whether the analysis in the *McEwen* advice letter is intended to apply to the factual circumstances presented in this audit.

***FPPC's Action: Fully implemented.***

In October 2012 the FPPC informed the California State Treasurer that, pursuant to its *McEwen* advice letter and other advice letters it has issued in the past, the compensation models of the joint powers authorities included in the audit (California Communities and Municipal Finance) do not violate the political reform act.

**Recommendation 1.3—See pages 18—23 of the audit report for information on the related finding.**

To be better informed about the compensation of their consultants, including any potential conflicts of interest, California Communities and Municipal Finance should require the consulting firms that staff their organizations to disclose the amount and structure of compensation provided to individual consultants, including disclosing whether any of this compensation is tied to the volume of bond sales.

***California Communities' Action: Partially implemented.***

California Communities indicated that its commission considered requiring HB Capital Resources, Ltd. (HB Capital) to disclose the amount of compensation paid to each of its employees. However, the commission concluded that it does not have discretion over such compensation. Instead, California Communities amended its contract with HB Capital in October 2012 to require HB Capital not to compensate its employees providing services directly or indirectly to the joint powers authority on a commission basis or pursuant to any other method of compensation that is based on the dollar amount or volume of bonds issued by the joint powers authority.

***Municipal Finance's Action: Pending.***

Municipal Finance stated that a subcommittee of its board members is reviewing proposed contract language that will prohibit its consultants from compensating their employees on a commission basis or any other method that is based on the volume of bonds sales. Municipal Finance indicated that the proposed contract language will also require all consultants to disclose the amount of compensation provided to individual employees.

**Recommendation 1.4—See page 28 of the audit report for information on the related finding.**

In implementing its January 2012 contracting policy, California Communities should either periodically subject existing contracts to competitive bidding or perform some other price comparison analysis to ensure that the public funds it oversees are used effectively.



***California Communities' Action: Pending.***

California Communities stated that the term of its contract with HB Capital does not expire until June 2015, and that the contract automatically extends for another two years unless California Communities gives written notice to HB Capital prior to May 2013 that it does not desire to extend the contract. California Communities indicated that at the beginning of 2013, its commission will consider whether to provide such notice and conduct a competitive bid process for selecting a program manager for a term commencing in July 2015. California Communities added that at the beginning of 2013, its commission will be reviewing each of its other consultant contracts to determine whether it would be timely to conduct a competitive bid process for one or more of these contracts.

**Recommendation 1.5—See pages 28 and 29 of the audit report for information on the related finding.**

Municipal Finance should follow its July 2012 policy that describes how it will select contractors and periodically review existing contractors' services and prices to ensure the public funds it oversees are used effectively.

***Municipal Finance's Action: Fully implemented.***

In July 2012 Municipal Finance's board compared Sierra Management's services and prices to other conduit bond issuers and concluded that it is receiving the best value for the public funds it oversees. Municipal Finance also sought competitive bids for issuer/special counsel services in November 2012, which it stated was a result of its review of the services it was receiving. Municipal Finance affirmed that it will continue to follow its July 2012 policy, stating that for any engagement for professional services with a duration of at least one year, its board will conduct a review on a periodic basis to assess and evaluate the performance of the service provider. It added that it expects to conduct a review on an annual basis each January.

**Recommendation 1.6—See pages 26 and 28 of the audit report for information on the related finding.**

As suggested by the Government Finance Officers Association guidance, California Communities and Municipal Finance should include provisions in their contracts prohibiting consultants from engaging in activities on behalf of the issuers that produce a direct or indirect financial gain to the consultants, other than the agreed-upon compensation, without the issuer's informed consent.

***California Communities' Action: Fully implemented.***

In October 2012 California Communities amended its contract with HB Capital to prohibit HB Capital from receiving any additional compensation, payment, or other financial benefit from any person in connection with the issuance of bonds by the joint powers authority, except for the compensation authorized by its contract.

***Municipal Finance's Action: Pending.***

Municipal Finance indicated that it is reviewing proposed contract language that would prohibit its consultants from engaging in activities on its behalf that produces a direct or indirect financial gain to the consultants without its informed consent. Municipal Finance added further that Sierra Management voluntarily restricts itself to serve Municipal Finance and no other financing authority.

**Recommendation 1.7—See pages 30 and 31 of the audit report for information on the related finding.**

Once the Securities and Exchange Commission (SEC) finalizes its definition of *municipal advisor*, California Communities should have its legal counsel review whether HB Capital should register with the Municipal Securities Rulemaking Board.

***California Communities' Action: Pending.***

California Communities noted that the SEC has not finalized the definition of municipal advisors, and has extended the temporary definition until September 2013. California Communities stated that its legal counsel will continue to monitor SEC communications for when the definition is finalized and conduct an independent review.

**Recommendation 2.1—See pages 34 and 35 of the audit report for information on the related finding.**

To provide more accessible venues for citizens to understand the financing of projects and to voice their opinions, the Health Financing Authority should either hold local approval hearings in each jurisdiction in which a project will be built or create a cost-effective technological solution (streaming video, teleconference, etc.) to provide more public accessibility.

***Health Financing Authority's Action: Fully implemented.***

The Health Financing Authority indicated that it will now provide telephone access for all of its local approval hearings so members of the public may participate via a toll-free phone call. The Health Financing Authority demonstrated its new process using an October 2012 hearing for the city of Hope. The Health Financing Authority published notices for this hearing in both *The Sacramento Bee* and in the *Los Angeles Times*. These notices included the date and time of the hearing, an address for members of the public who wished to attend in person, and a toll-free number and participation code for members of the public who wished to participate remotely.

**Recommendation 2.2—See page 39 of the audit report for information on the related finding.**

To ensure that all issuers of conduit revenue bonds make their activities sufficiently transparent to the public, the Legislature should consider amending state law to provide deadlines for issuers to post the information SB 99 requires on their Web sites and to specify how long issuers must keep this information posted.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

# Children's Hospital Program

## Fund Disbursements Are Appropriate, but Estimates of Cash Needs Have Been Consistently High

### REPORT NUMBER 2012-042, ISSUED JULY 2012

This report concludes that the California Health Facilities Financing Authority (authority), which administers the program, complied with laws and regulations related to awarding grants for eligible hospitals to construct or improve children's facilities. Further, the authority has a process for monitoring grants and has processed payments to grantees in accordance with the law. However, the authority's administration of the program could be more efficient. The authority requested bond sales that were in excess of its cash needs at a time when California's credit rating was low and interest-rate volatility was high. As a result, the State paid as much as \$16 million in interest annually on the idle capital while the State was facing cash shortfalls.

Although the authority could not have foreseen or mitigated all of the circumstances that led to an excessive fund balance, its estimates of cash needs have consistently been well above actual disbursements. This pattern, as well as some hospital project delays that it could have anticipated, indicate that the authority needs to revise the way it makes yearly projections of cash needs. In particular, the authority currently includes in its estimates the projected cash needs of hospitals that have not yet submitted a project application for approval.

In the report, the California State Auditor (state auditor) made the following recommendations to the authority. The state auditor's determination regarding the current status of recommendations is based on the authority's response to the state auditor as of September 2012.

#### **Recommendation 1—See pages 13—15 of the audit report for information on the related finding.**

To avoid contributing to the State's financial strain, the authority should limit future bond sales to the level of disbursements it reasonably expects to make during the following six-month period.

#### ***Authority's Action: Pending.***

The authority indicates it has not requested additional bond funds.

#### **Recommendation 2—See pages 10 and 11 of the audit report for information on the related finding.**

The authority should reduce its current cash balance by continuing to make disbursements to hospitals while refraining from requesting additional bond sales. If the authority believes it needs to retain a portion of its cash balance as a contingency reserve for unforeseen circumstances, it should perform and document an analysis demonstrating the appropriateness of the reserve level it adopts.

#### ***Authority's Action: Pending.***

As noted above, the authority indicates that it has not requested additional bond funds, and that it continues to process requests for disbursements of grant funds received from hospitals. The authority reports it has undertaken an analysis with its financial advisor to identify an appropriate reserve level, and expects to report on the results of this analysis and the resulting implementation plans in its six-month response.

**Recommendation 3—See page 16 of the audit report for information on the related finding.**

To allow for more accurate planning of upcoming cash needs, the authority should refine its cash-projection process to more accurately reflect its near-term cash needs. Specifically, the authority should refrain from requesting additional bond sales for projects that have not yet received project approval from the authority.

***Authority's Action: Pending.***

As part of the analysis described in Recommendation 2, the authority indicates its financial advisor will provide guidance in forecasting grant disbursement needs. It further indicates it will not request bond funds for projects that have not yet received project approval from the authority.

**Recommendation 4—See pages 16 and 17 of the audit report for information on the related finding.**

For hospitals with existing projects, the authority should request written confirmation from hospitals that detail when the hospitals will submit disbursement requests for approved funds.

***Authority's Action: Pending.***

The authority indicates that, upon execution of new grant agreements, it will request that the grantee provide in writing the projections of timing and the amount of disbursement requests.

# California Housing Finance Agency

## Most Indicators Point to Continued Solvency Despite Its Financial Difficulties Created, in Part, by Its Past Decisions

### REPORT NUMBER 2010-123, ISSUED FEBRUARY 2011

This report concludes that, although the California Housing Finance Agency (CalHFA) will continue to face significant risks, its major housing programs and the fund it uses to pay its operating expenses should remain solvent under most foreseeable circumstances. The report also concludes that past decisions by CalHFA, such as its decisions to significantly increase its use of variable-rate bonds and interest-rate swap agreements, and to launch new mortgage products that were easier for borrowers to qualify for, but that eventually proved to have high delinquency rates, contributed to its current difficulties. These decisions revealed the need for changes in how its board of directors (board) governs the agency. In particular, CalHFA's board should approve any new debt-issuance strategy or mortgage product prior to its implementation, which is something it had not always done in the past, and should include language in its annual resolutions delegating authority to CalHFA staff restricting staff's actions to the debt strategies and mortgage products specified in the annual delegations themselves, approved business plans, or subsequent board resolutions.

In the report, the California State Auditor (state auditor) made the following recommendations to CalHFA. The state auditor's determination regarding the current status of recommendations is based on CalHFA's response to the state auditor as of August 2011.

#### **Recommendation 2.1—See page 50 of the audit report for information on the related finding.**

To ensure that CalHFA's business plans and strategies are thoroughly vetted by an experienced and knowledgeable board, the Legislature should consider amending the statute that specifies the composition of CalHFA's board to include appointees with specific knowledge of housing finance agencies, single-family mortgage lending, bonds and related financial instruments, interest-rate swaps, and risk management.

#### ***Legislative Action: Partially implemented.***

Chapter 408, Statutes of 2011 (Assembly Bill 1222), allows individuals affiliated with the housing, banking, insurance, and other specified industries to serve on the CalHFA board, even though they may have a conflict of interest, provided they publicly disclose the interest and do not attempt to influence or participate in the decision in which they have an interest.

#### **Recommendation 2.2—See pages 49, 50, 58, and 59 of the audit report for information on the related finding.**

To provide better oversight of CalHFA, its board should issue a policy stating that it must approve any new debt-issuance strategy or mortgage product prior to its implementation, either directly or by inclusion in CalHFA's annual business plan. The board should, where appropriate, prescribe limits on how much of the debt portfolio can be fixed- or variable-rate bonds, and what proportion of the loans it purchases can consist of mortgage products it identifies as riskier than other mortgage products.

#### ***CalHFA's Action: Fully implemented.***

A board resolution approved May 2011 requires staff to present new financing strategies and new loan products for full discussion and approval by majority vote of the board prior to implementation by CalHFA. This resolution also specifies that proposed annual business plans submitted to the board by CalHFA staff shall address limitations on the use of variable rate debt and identification of loan products that CalHFA identifies as involving higher levels of risk than traditional CalHFA loan products.

**Recommendation 2.3—See pages 49, 50, 58, and 59 of the audit report for information on the related finding.**

Within its annual resolutions delegating authority to CalHFA staff, the CalHFA board should include language restricting staff's actions regarding debt strategies and mortgage products to those specified in the annual delegations themselves, the approved business plans, or subsequent board resolutions.

***CalHFA's Action: Fully implemented.***

Board resolutions approved in January 2011 and amended in March 2011 include restrictions on actions CalHFA staff may take regarding debt strategies and mortgage products. When taken together with the May 2011 board resolution (mentioned above), these actions restrict CalHFA staff to implementing only financing strategies and loan products approved by the board.

# Federal Workforce Investment Act

## More Effective State Planning and Oversight Is Necessary to Better Help California's Job Seekers Find Employment

### REPORT NUMBER 2011-111, ISSUED MARCH 2012

This report concludes that the California Workforce Investment Board (state board) has failed to develop a strategic workforce plan for California, as required by state law since 2006. In addition, the state board has failed to maintain a majority of members who represent businesses throughout the State, a situation that violates the requirements of the federal Workforce Investment Act of 1998 (WIA) and that may prevent the state board from making recommendations that adequately represent California's business community. Finally, although it has been developing relationships with other entities in an effort to improve the statewide workforce investment system, the state board does little to ensure the nonduplication of services that program participants receive because it did not begin reviewing the local boards' plans until program year 2011 (the U.S. Department of Labor's (Labor) program year runs from July 1 through June 30), and its review did not include steps to identify unnecessary duplication of services. To review the local boards' plans and the activities funded by WIA, the state board needs performance measures and data from workforce investment activities around California. The Employment Development Department (EDD) could not provide those entities involved in workforce investment programs and activities with sufficient data to develop performance measures specifically for California because the primary function of its Job Training Automation system and its new Web-based system is to meet federal reporting requirements. In addition, because EDD did not always demonstrate its compliance with WIA provisions when awarding a certain type of funding to local boards and a community-based organization, it increased the State's risk of possibly losing WIA funding. Finally, EDD is not maximizing the federal funding opportunities available for workforce investment, and thus it is not availing itself of additional funds the State can use to help job seekers obtain employment. We noted six missed opportunities for federal grants that could have provided up to \$10.5 million in additional funds for the workforce investment efforts of the State.

In the report, the California State Auditor (state auditor) made the following recommendations to the Legislature, the California Labor and Workforce Development Agency (labor agency), the state board, and EDD. The state auditor's determination regarding the current status of recommendations is based on responses from the labor agency, the state board, and EDD to the state auditor as of October 2012.

#### **Recommendation 1.1—See pages 19—21 of the audit report for information on the related finding.**

To ensure that the state board promptly develops a strategic workforce plan, the Legislature should consider amending the pertinent statutes to establish a due date for the plan.

#### ***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

#### **Recommendation 1.2—See pages 23—30 of the audit report for information on the related finding.**

To comply with WIA requirements for state boards, the Legislature should consider amending the pertinent statutes to clarify the roles and responsibilities of the state board and EDD.

#### ***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.



**Recommendation 1.3—See pages 22 and 23 of the audit report for information on the related finding.**

To make certain that the state board meets the WIA requirement that a majority of the members are representatives of California businesses, the labor agency should continue working with the Governor's Office to identify and appoint a sufficient number of business representatives to the state board as soon as possible.

***Labor Agency's Action: Partially implemented.***

The labor agency stated that the governor has made numerous appointments to the state board and that the governor was considering more appointments. Further, according to the state board's chief of operations, four more appointments are still needed to be made to achieve the 51 percent business majority. He also stated that the state board's executive director was working with the labor agency's secretary and the Governor's Office to make these appointments as soon as possible.

**Recommendation 1.4.a—See pages 19—21 of the audit report for information on the related finding.**

To assist the governor in the development, oversight, and continuous improvement of California's workforce investment system, the state board should collaborate with state and local workforce investment partners to promptly develop and implement a strategic workforce plan as state law requires. The strategic plan should include, at a minimum, the following elements: clear roles and responsibilities pertaining to the state board, EDD, and other state and local workforce partners; clear definitions for terminology used in the strategic plan, such as *quality services*; performance measures that are specific to California for evaluating the efficiency and effectiveness of WIA-funded programs and activities; and procedures for approving the addition of data elements to EDD's Web-based system and for the exchange of data between EDD and the state board to facilitate the development and implementation of performance measures that are specific to California.

***State Board's Action: Partially implemented.***

According to the labor agency, it intends to submit a revised strategic workforce plan to Labor before April 1, 2013. Furthermore, the state board stated that it was continuing to discuss with EDD the procedures for incorporating additional data elements. It indicated that by early 2013, the state board and EDD will finalize the additional data elements that local one-stop staff will be required to complete and will finalize the specific reports the state board will need to evaluate the quality and effectiveness of the program.

**Recommendation 1.4.b—See pages 23—26 of the audit report for information on the related finding.**

To assist the governor in the development, oversight, and continuous improvement of California's workforce investment system, the state board should continue to exercise its legal authority to review the local boards' plans to, among other things, assure the coordination and nonduplication of services to program participants.

***State Board's Action: Partially implemented.***

The state board stated that it is taking the lead role in establishing the content of the local plans and in communicating its expectations as part of the review and approval process to ensure that local plans are consistent with the state board's vision and goals for California's workforce investment system. It also stated that once Labor approves the integrated strategic workforce development plan, the state board will work with EDD to issue a directive outlining the required contents of the local plans as well as the state board's new role as the reviewer and approver of these plans.



**Recommendation 1.5—See pages 26—30 of the audit report for information on the related finding.**

To assist the state board and other workforce investment partners in the development and implementation of state-specific performance measures, EDD should ensure that it works with the state board to develop procedures for approving the addition of data elements to its Web-based system and for the exchange of data between EDD and the state board.

***EDD's Action: Pending.***

According to the EDD, it convened preliminary meetings with the state board to ensure that procedures are put in place for considering and approving the collection of additional data elements. EDD also stated that after Labor approves the integrated strategic workforce development plan, EDD will develop and disseminate new procedures in collaboration with the state board and its staff that will allow for the identification of possible new state performance measures and the sharing of additional information with the state board and other stakeholders.

**Recommendation 1.6—See pages 30 and 31 of the audit report for information on the related finding.**

To comply with WIA requirements and eliminate the State's risk of losing funds, EDD should ensure that it awards rapid-response funding for additional assistance only to local boards or community-based organizations that demonstrate that their local areas experience natural disasters, mass layoffs, plant closings, or other dislocation events when such events substantially increase the number of unemployed individuals.

***EDD's Action: Pending.***

EDD stated that it convened preliminary meetings with the state board to ensure that state policy is consistent with federal rules and to refine its application procedures to ensure that it awards additional assistance funding only to local boards or community-based organizations for local areas that experience natural disasters, mass layoffs, plant closings, or other dislocation events when such events substantially increase the number of unemployed individuals. EDD also stated that work on the policy has been delayed pending approval by Labor of the integrated strategic workforce development plan.

**Recommendation 1.7.a—See pages 32—35 of the audit report for information on the related finding.**

To ensure that the State maximizes federal funding opportunities related to workforce investment, EDD should update its written policy to include, at a minimum, the following procedures: the methods it will use to identify federal grant opportunities, the factors it will consider in its decision to pursue or forego applying for these grants, and the process by which it will document its final decision to either pursue or forego the grant opportunity.

***EDD's Action: Fully implemented.***

EDD established grant recommendation procedures to ensure it sufficiently documents the steps taken, factors considered, and decisions made regarding grant opportunities.

**Recommendation 1.7.b—See pages 32—35 of the audit report for information on the related finding.**

To ensure that the State maximizes federal funding opportunities related to workforce investment, EDD should implement the updated policy as soon as practicable.

***EDD's Action: Fully implemented.***

EDD indicated that its grant recommendation procedures have been implemented since at least April 2012.



# Employment Development Department

## Its Unemployment Program Has Struggled to Effectively Serve California's Unemployed in the Face of Significant Workload and Fiscal Challenges

### REPORT NUMBER 2010-112, ISSUED MARCH 2011

This report concludes that over the last 10 years the Employment Development Department (department) has consistently failed to perform at a level the United States Department of Labor considers acceptable regarding its timely delivery of unemployment benefits. The department's attempts to resolve its performance deficiencies have had mixed results. Although increasing its staff and allowing them to work overtime has enabled the department to process significantly more claims, mitigate the effects of furloughs, and likely improve its performance, it has not fully implemented certain key corrective actions and the impact of others has been minimal or remains unclear. In addition, historical data the department provided us indicated that its previous phone system did not have the capacity to handle the necessary volume of calls and a high percentage of callers requesting to speak to an agent were unable to do so. The department activated its new phone system at its six main call center locations by December 2010. Although it is too early to tell using data from the new system, our limited capacity analysis suggests that the new system should be able to handle a substantially higher volume of calls; however, access to agents may continue to be a challenge. Moreover, in order to receive \$839 million in federal stimulus funds, the department must implement an alternate base period no later than September 2012 that would allow certain unemployed workers (claimants) to qualify for benefits if their earnings are not sufficient under the standard base period. Although the department stated that it will implement the alternate base period in April 2012, it is critical that it does so before the federal deadline. Finally, the department's process for determining California Training Benefits program eligibility for claimants has taken an average of four or more weeks, during which time the claimants did not receive unemployment benefits. Although the department has streamlined this process for some claimants, it does not appear to have a clear plan to improve its procedures for 80 percent of its determinations that involve claimants who desire to participate in self-arranged training.

In the report, the California State Auditor (state auditor) made the following recommendations to the department and the California Technology Agency (Technology Agency).<sup>1</sup> The state auditor's determination regarding the current status of the recommendations is based on the department's response to the state auditor as of March 2012, the Technology Agency's response as of March 2012, and a letter report dated November 13, 2012, that presents a follow-up review conducted by the state auditor concerning the department's progress in implementing the recommendations.

#### **Recommendation 1.1.a—See pages 27—34 of the audit report for information on the related finding.**

To further enhance its corrective action planning process as a means of improving the unemployment program, the department should identify corrective actions that specifically address the timeliness measures it is trying to meet.

#### ***Department's Action: Fully implemented.***

The department's 2012 State Quality Service Plan (quality plan), which serves as the principal vehicle for planning, recording, and managing its unemployment program's efforts to strive for excellence in service, includes corrective actions to address federal timeliness measures for promptly issuing initial unemployment payments and making nonmonetary determinations of claimant's eligibility for benefits.

<sup>1</sup> Chapter 404, Statutes of 2010, which became effective January 1, 2011, renames the Office of the State Chief Information Officer as the California Technology Agency and the position of the State's chief information officer as the Secretary of California Technology.

**Recommendation 1.1.b—See pages 27—34 of the audit report for information on the related finding.**

To further enhance its corrective action planning process as a means of improving the unemployment program, the department should develop milestones that are specific and are tied to corrective actions to allow for monitoring the incremental progress of its corrective actions, similar to the milestones it established for some of the activities in its federal fiscal year 2011 corrective action plans.

***Department's Action: Fully implemented.***

The department's quality plan for 2012 now has corrective actions with related milestones.

**Recommendation 1.1.c—See pages 27—34 of the audit report for information on the related finding.**

To further enhance its corrective action planning process as a means of improving the unemployment program, the department should establish several key performance targets or benchmarks that are tied to each specific corrective action, to effectively gauge the impact of the actions on its goal of achieving the acceptable levels related to the timeliness measures.

***Department's Action: No action taken.***

- ➔ Although the department has now established corrective action plans with related milestones, it has not created ways to measure how those actions affect the department's performance. Specifically, even though the federal labor department approved the department's 2012 quality plan, we noted that the plan still does not include specific performance targets or benchmarks related to its corrective actions.

**Recommendation 1.2.a —See pages 34—40 of the audit report for information on the related finding.**

As part of an overall strategy to limit the number of calls it receives while still providing timely and effective customer service, the department should use existing data and additional data from the new phone system to gain a better understanding of why people request to speak to an agent. Using this information, the department should further develop strategies and measurable goals related to achieving a reduction in call volumes. For example, to ensure that virtually all calls are able to gain access to the voice response portion of its new phone system, the department should monitor the volume of blocked call attempts and work with its phone system vendor if necessary to increase the system's capacity.

***Department's Action: No action taken.***

- ➔ During our follow-up review the department informed us of four projects it had undertaken related to this recommendation. However, it did not provide any analyses of data from its new phone system that led to these efforts, nor did the documents the department provided identify any measurable goals for reducing call volume. Moreover, even though our follow-up review found that millions of callers continue to have difficulty accessing the department's new phone system and its agents and the number and percentage of blocked calls remain high, the department has not developed any specific goals related to reducing its blocked call rate.

**Recommendation 1.2.b—See pages 34—40 of the audit report for information on the related finding.**

As part of an overall strategy to limit the number of calls it receives while still providing timely and effective customer service, the department should use existing data and additional data from the new phone system to gain a better understanding of why people request to speak to an agent. Using this information, the department should further develop strategies and measurable goals related to achieving a reduction in call volumes. For example, to evaluate the effectiveness of its other efforts to

provide services to claimants in ways that do not require them to speak to agents, such as Web-Cert and Tele-Cert, the department should periodically summarize and assess the more robust management information available under its new phone system.

***Department's Action: No action taken.***

The department has not used information from the new phone system to evaluate the effectiveness of its self-service options or to target its efforts to reduce call volume. Although the phone system contractor maintains the voice response system data in a database it manages and the department has access to this information through standard reports, the department did not use this information to address our recommendation. In addition, the contractor exports this information to an external unemployment insurance program database from which the department can access the information through custom reports it can create. However, based on a request for information from the external database we made during our follow-up review, the department determined a significant amount of data was missing from the external database; thus, the department could not have accurately evaluated its self-service options using this database.

**Recommendation 2.1—See pages 44—47 of the audit report for information on the related finding.**

To maximize federal funding and provide unemployment benefits to those eligible under the alternate base period, the department should closely monitor its resources and project schedule to avoid any further delays in implementing the client database and ensure that it completes the alternate base period project by the federal deadline.

***Department's Action: Fully implemented.***

The federal labor department certified the department's application for incentive funds in June 2011 and the department received a maximum transfer of \$839 million in July 2011. In July 2012 the department reported to the Legislature that it had successfully implemented the alternate base period and that it had processed 1,767 valid claims for the alternate base period as of May 12, 2012, which we verified.

**Recommendation 2.2—See pages 44—47 of the audit report for information on the related finding.**

To help ensure that the department completes the alternate base period project by the federal deadline so that the State preserves its eligibility to receive \$839 million in incentive funds, the Technology Agency should closely monitor the department's progress toward implementing the client database and alternate base period projects and provide assistance to the department, as necessary.

***Technology Agency's Action: Fully implemented.***

According to its one-year response, the Technology Agency monitored monthly project status reports and project schedules and met with the department bi-weekly to review progress, issues, and risks specific to the Alternate Base Period project.

**Recommendation 2.3.a—See pages 48—57 of the audit report for information on the related finding.**

To better track and improve the timeliness of determinations for the training benefits program and to assist claimants in understanding self-arranged training requirements, the department should take measures to ensure that its staff correctly enter all data into the training benefits program's streamline database.

***Department's Action: Fully implemented.***

The department reported that it had made corrections to the database to ensure that data fields are validated and to prevent blank or empty fields. Our follow-up review assessed the data in the streamline database, and the department appears to have corrected the issues we initially identified.

**Recommendation 2.3.b—See pages 48—57 of the audit report for information on the related finding.**

To better track and improve the timeliness of determinations for the training benefits program and to assist claimants in understanding self-arranged training requirements, the department should track and report the number of claimants it determines are both eligible and ineligible for the self-arranged training and the reasons for these determinations, to better focus some of its recommendations toward how it can assist claimants in understanding the program's criteria.

***Department's Action: Partially implemented.***

According to its one-year response, the department is using a weekly report to track the number of and reasons for its self-arranged training determinations, and it started doing so with data from the week ending July 9, 2011. During our current review, we found that although the department reports that it now tracks the information, it has not yet used it to develop recommendations for the report it must submit in 2016.

**Recommendation 2.3.c—See pages 48—57 of the audit report for information on the related finding.**

To better track and improve the timeliness of determinations for the training benefits program and to assist claimants in understanding self-arranged training requirements, the department should track the number of claimants that it finds to be both ineligible for self-arranged training and ultimately ineligible for unemployment benefits and develop strategies to expedite the determination process for these claimants.

***Department's Action: No action taken.***

- ➔ The department did not specifically address this recommendation in its 60-day, six-month, or one-year response. In our follow-up review the program analysis and evaluation section chief stated the department has not tracked the number of these claimants because doing so would be labor-intensive and time-consuming and the reporting unit that would be responsible for the tracking is short-staffed.

# City of San José

## Some Retirement Cost Projections Were Unsupported Although Rising Retirement Costs Have Led to Reduced City Services

### REPORT NUMBER 2012-106, ISSUED AUGUST 2012

This report concludes that during fiscal years 2009–10 through 2011–12, the City of San José (San José) experienced financial challenges as its budgeted revenues declined and retirement costs—consisting of pension and postemployment health benefits—increased. Although we believe that San José’s financial challenges are real, we found that some of the retirement cost projections reported in San José’s official documents in 2011 were not supported by accepted actuarial methodologies, nor were the underlying assumptions vetted and approved by the boards of San José’s two retirement plans. For example, in supporting the need to reduce retirement benefits, the mayor and certain city council members referred to a projection that the city’s annual retirement costs could increase to \$650 million by fiscal year 2015–16, a projection that our actuarial consultant determined was unsupported and likely overstated when assumptions approved by the boards of the two retirement plans are considered. Although we have concerns with some of San José’s projected retirement costs for future years, its actual retirement costs increased significantly from fiscal years 2009–10 through 2011–12. These increased costs appear to have crowded out some of the funding previously available for nonpublic safety services, such as parks and libraries.

In the report, the California State Auditor (state auditor) made the following recommendation to San José. The state auditor’s determination regarding the current status of the recommendation is based on San José’s response to the state auditor as of October 2012.

#### **Recommendation—See pages 15—20 of the audit report for information on the related finding.**

To ensure that stakeholders receive consistent and reliable information, San José should report the official retirement cost projections that were developed using the assumptions approved by the boards of the two retirement plans. If San José does not use the official retirement cost projections, it should develop projections that are supported by accepted actuarial methodologies, report this information in the correct context, and disclose significant assumptions that differ from those in the boards’ retirement cost projections.

#### ***San José’s Action: Pending.***

San José reported that it continues to implement our recommendation. Similar to its initial response to our report, San José reiterated that the retirement cost projections used in its most recent five-year budget forecast, released in February 2012, were developed by the actuary used by the boards of the two retirement plans, using assumptions that were also approved by both boards. However, as we discussed in our report, San José has not always done this. Therefore, we look forward to seeing that San José uses retirement cost projections developed by the actuary used by the boards of its two retirement plans based on board-approved assumptions in its next five-year budget forecast. San José expects to release its next forecast in early 2013.





# City of Vernon

## Although Reform Is Ongoing, Past Poor Decision Making Threatens Its Financial Stability

### REPORT NUMBER 2011-131, ISSUED JUNE 2012

This report concludes that although the City of Vernon (city) is enacting reforms, it has not yet developed policies necessary to implement some reforms and for others it will take years to achieve the full benefits. The city also has not properly managed its executive positions by failing to establish minimum qualifications for several key leaders, including the city administrator. Further, the city may not have chosen positions in the most comparable cities for its May 2011 survey of executive salaries, potentially skewing salaries upward. The city may have also provided legally questionable retirement benefits to certain past and current executives.

The city has weak internal controls over contracting and our analysis revealed problems in 21 of the 25 service and consultant contracts we reviewed. Further, the city did not always ensure compliance with its conflict-of-interest code, which requires it to determine whether consultants it hires perform duties that require disclosure of economic interests.

For more than 20 years the city's general fund has operated at a structural deficit because the current revenue structure does not fully pay for the general fund's services. The city has funded past general fund deficits through reserves, transfers and loans from other funds, and one-time revenues. Although such practices may be common among cities, the city's continued reliance on other funds to cover its general fund deficit is now problematic because the funds available from these sources have decreased. As of March 2012 the city had \$571 million in outstanding bonds, mostly for its power department. However, the power department has struggled to manage its debt burden while maintaining competitive electric rates. The power department is forecasting a \$24 million deficit in fiscal year 2013–14, creating a need for electric rate increases.

Our finance and energy expert found that the city could not demonstrate that it performed the expected analyses for past energy decisions, such as purchasing a 15-year supply of natural gas for the city's power plant, which it then sold nearly two years later. Because the city used tax-exempt bonds to purchase the gas, selling the power plant created the need for the city to also sell this prepaid natural gas supply to an eligible buyer or risk losing the bond's tax-exempt status; as a result, it sold the gas at a significant discount. Finally, the city has used interest rate swaps to hedge risks associated with issuing bonds, which is a practice consistent with other cities. However, our finance and energy expert found that the city's use of swaps has proved costly—it terminated all but two of its swaps at a cost of \$33.4 million, and as of February 2012, it would have needed to pay \$47 million to terminate the remaining two swaps.

In the report, the California State Auditor (state auditor) made the following recommendations to the city. The city did not submit a six-month response to the audit when it was due to the state auditor in December 2012. Therefore, the state auditor's determination regarding the current status of recommendations is based on the city's August 27, 2012, 60-day response to the state auditor.

#### **Recommendation 1.1.a—See pages 22—24 of the audit report for information on the related finding.**

To increase accountability and transparency in its governance, the city should ensure that specific reforms are appropriately implemented. Specifically, it should develop an implementation plan containing sufficient detail to establish the activities and coordination required to successfully implement an alternative new employment system so that its nonunion employees are no longer at-will employees of the city council.

***City's Action: Pending.***

The city indicated that its human resources director and city attorney, who were both recently appointed, will review and recommend civil service procedures, but it has not provided detail on the steps it intends to take to develop these procedures.

**Recommendation 1.1.b—See pages 25 and 26 of the audit report for information on the related finding.**

To increase accountability and transparency in its governance, the city should determine whether it will continue to own housing and communicate its decision to the public as soon as appropriate. Should the city decide to retain ownership of the housing, it should continue the effort to develop policies and procedures that are necessary to ensure fairness and impartiality in its management of city-owned housing.

***City's Action: No action taken.***

➡ The city did not address this recommendation in its August 2012 response.

**Recommendation 1.1.c—See pages 25 and 26 of the audit report for information on the related finding.**

To increase accountability and transparency in its governance, the city should continue the effort to develop a comprehensive plan to construct additional housing in the city.

***City's Action: Partially implemented.***

The city, with input from the Housing Commission counsel and a legislative member's office, has selected a housing developer and is in the process of developing the necessary agreements for city council approval that will result in a comprehensive housing plan for the construction of additional city housing.

**Recommendation 1.1.d—See page 24 of the audit report for information on the related finding.**

To increase accountability and transparency in its governance, the city should develop a formal policy that describes the circumstances under which revenues can be transferred from its power department, and the limits and permissible uses of transferred revenue.

***City's Action: No action taken.***

➡ The city did not address this recommendation in its August 2012 response.

**Recommendation 1.2.a—See pages 27 and 28 of the audit report for information on the related finding.**

To ensure that it develops complete and appropriate personnel policies and procedures, the city should continue its efforts to hire an experienced human resources director.

***City's Action: Fully implemented.***

The city appointed a human resources director to start in September 2012.

**Recommendation 1.2.b—See pages 27 and 28 of the audit report for information on the related finding.**

To ensure that it develops complete and appropriate personnel policies and procedures, the new human resources director should ensure that the city's policies and procedures include, at a minimum, requirements for performing and documenting the analyses and justifications for appointments, including promotions, to management positions.

***City's Action: Pending.***

Although the city indicated that its recently appointed human resources director will review and recommend improvements to personnel policies and procedures, the city did not specifically respond to our recommendations, elaborate on any plans to improve its policies and procedures, or give a time frame for completion.

**Recommendation 1.2.c—See pages 27 and 28 of the audit report for information on the related finding.**

To ensure that it develops complete and appropriate personnel policies and procedures, the new human resources director should ensure that the city's policies and procedures include, at a minimum, requirements for minimum qualifications, desirable qualifications, and job duties for all city executive positions.

***City's Action: Pending.***

Although the city indicated that its recently appointed human resources director will review and recommend improvements to personnel policies and procedures, the city did not specifically respond to our recommendations, elaborate on any plans to improve its policies and procedures, or give a time frame for completion.

**Recommendation 1.2.d—See pages 27 and 28 of the audit report for information on the related finding.**

To ensure that it develops complete and appropriate personnel policies and procedures, the new human resources director should ensure that the city's policies and procedures include, at a minimum, a periodic appraisal process for executives.

***City's Action: Pending.***

Although the city indicated that its recently appointed human resources director will review and recommend improvements to personnel policies and procedures, the city did not specifically respond to our recommendations, elaborate on any plans to improve its policies and procedures, or give a time frame for completion.

**Recommendation 1.2.e—See pages 28—34 of the audit report for information on the related finding.**

To ensure that it develops complete and appropriate personnel policies and procedures, the new human resources director should ensure that the city's policies and procedures include, at a minimum, an improved methodology for and analysis of future salary surveys, ensuring that they are performed by staff or a consultant with experience and expertise in the area of salary surveys.

***City's Action: Pending.***

Although the city indicated that its recently appointed human resources director will review and recommend improvements to personnel policies and procedures, the city did not specifically respond to our recommendations, elaborate on any plans to improve its policies and procedures, or give a time frame for completion.

**Recommendation 1.3—See pages 34 and 35 of the audit report for information on the related finding.**

The city should determine whether employees have a vested right to longevity payments and whether it can legally reduce or discontinue the original longevity program as a means to reduce its costs.

*City's Action: No action taken.*

- ➔ The city did not address this recommendation in its August 2012 response.

**Recommendation 1.4—See pages 36—38 of the audit report for information on the related finding.**

To ensure accurate reporting and payment of retirement benefits, the city should work with California Public Employees' Retirement System (CalPERS) to resolve the reported findings and observation noted in CalPERS April 2012 audit report within a reasonable period of time.

*City's Action: Partially implemented.*

The city has begun reporting its attorney contributions under the miscellaneous classification and is working with CalPERS to remove the safety classification for attorneys from its contract.

**Recommendation 2.1.a—See pages 42 and 43 of the audit report for information on the related finding.**

To better control contract expenditures and ensure that it receives the best value for the services it purchases, the city should require that all city contracts be entered into its enterprise resource planning (ERP) system so that the contract managers and the city can more efficiently and effectively track the city's contract expenditures.

*City's Action: Pending.*

The city states that a top priority for its recently appointed city attorney will be to develop a comprehensive contracting policy resolution for city council approval, but it did not give a time frame for completion.

**Recommendation 2.1.b—See pages 42 and 43 of the audit report for information on the related finding.**

To better control contract expenditures and ensure that it receives the best value for the services it purchases, the city should also begin using the ERP system's uniquely assigned contract numbers for tracking and generating a list of contracts.

*City's Action: No action taken.*

- ➔ The city did not address this recommendation in its August 2012 response.

**Recommendation 2.1.c—See pages 43—47 of the audit report for information on the related finding.**

To better control contract expenditures and ensure that it receives the best value for the services it purchases, the city should require all contracts to have expenditure limits and starting and ending dates for services performed.

*City's Action: Pending.*

The city states that a top priority for its recently appointed city attorney will be to develop a comprehensive contracting policy resolution for city council approval, but it did not give a time frame for completion.

**Recommendation 2.1.d—See pages 47—51 of the audit report for information on the related finding.**

To better control contract expenditures and ensure that it receives the best value for the services it purchases, the city should require contract managers to use logs to monitor payments and the contractor's progress toward completion of required deliverables.

***City's Action: Pending.***

The city states that a top priority for its recently appointed city attorney will be to develop a comprehensive contracting policy resolution for city council approval, but it did not give a time frame for completion.

**Recommendation 2.1.e—See pages 47—51 of the audit report for information on the related finding.**

To better control contract expenditures and ensure that it receives the best value for the services it purchases, the city should require that all contracts contain a well-defined scope of work and deliverables that a sufficiently detailed invoice can be measured against.

***City's Action: Pending.***

The city states that a top priority for its recently appointed city attorney will be to develop a comprehensive contracting policy resolution for city council approval, but it did not give a time frame for completion.

**Recommendation 2.1.f—See pages 47—51 of the audit report for information on the related finding.**

To better control contract expenditures and ensure that it receives the best value for the services it purchases, the city should ensure that contracts include language requiring contractors to provide invoices with sufficient detail so that contract managers can determine whether the services provided are consistent with the scope of work.

***City's Action: Pending.***

The city states that a top priority for its recently appointed city attorney will be to develop a comprehensive contracting policy resolution for city council approval, but it did not give a time frame for completion.

**Recommendation 2.1.g—See pages 47—51 of the audit report for information on the related finding.**

To better control contract expenditures and ensure that it receives the best value for the services it purchases, the city should also require the finance department to review invoices to identify those that lack sufficient detail and return such invoices to the appropriate contract manager to obtain a revised invoice that is sufficiently detailed.

***City's Action: Pending.***

The city states that a top priority for its recently appointed city attorney will be to develop a comprehensive contracting policy resolution for city council approval, but it did not give a time frame for completion.

**Recommendation 2.1.h—See pages 51—53 of the audit report for information on the related finding.**

To better control contract expenditures and ensure that it receives the best value for the services it purchases, the city should continue its efforts to develop and implement policies and procedures for a competitive bidding process, including clearly defining the circumstances under which forgoing competitive bidding is appropriate.

*City's Action: Pending.*

The city states that a top priority for its recently appointed city attorney will be to finalize the proposed comprehensive contract and purchasing ordinance that establishes an open and competitive bidding process for service contracts as required by the city charter, but it did not give a timeframe for completion.

**Recommendation 2.2—See page 53 of the audit report for information on the related finding.**

To the extent that the city implements policies that affect contracts, the city should also ensure that it reviews all current contracts and amends them, if necessary, to comply with newly established policies.

*City's Action: Pending.*

The city states that a top priority for its recently appointed city attorney will be to develop a comprehensive contracting policy resolution for city council approval, but it did not give a time frame for completion.

**Recommendation 2.3.a—See pages 53 and 54 of the audit report for information on the related finding.**

To improve its internal controls, better control costs, and prevent abuse from occurring, the city should require the finance department to review credit card expenditures for appropriateness.

*City's Action: No action taken.*

➔ The city did not address this recommendation in its August 2012 response.

**Recommendation 2.3.b—See page 54 of the audit report for information on the related finding.**

To improve its internal controls, better control costs, and prevent abuse from occurring, the city should revise its travel and expense reimbursement policy to be clear about the expenditure limits for meals, and add a limit for lodging accommodations.

*City's Action: No action taken.*

➔ The city did not address this recommendation in its August 2012 response.

**Recommendation 2.4.a—See pages 55 and 56 of the audit report for information on the related finding.**

To comply with the Political Reform Act (reform act), the city should ensure that the city administrator and city clerk are appropriately trained to administer its conflict-of-interest code (conflict code).

*City's Action: No action taken.*

➔ The city did not address this recommendation in its August 2012 response.

**Recommendation 2.4.b—See pages 55 and 56 of the audit report for information on the related finding.**

To comply with the reform act, the city should continue to ensure that all city executives file statements of economic interests, as its conflict code requires.

*City's Action: No action taken.*

The city did not address this recommendation in its August 2012 response.



**Recommendation 2.4.c—See pages 55 and 56 of the audit report for information on the related finding.**

To comply with the reform act, with regard to consultants, the city should review its existing contracts and have the city administrator determine which consultants should file statements of economic interests. The city should retain documentation of the city administrator's determinations and also forward them to the city council for review.

*City's Action: No action taken.*

The city did not address this recommendation in its August 2012 response.



**Recommendation 2.4.d—See pages 55 and 56 of the audit report for information on the related finding.**

To comply with the reform act, the city should ensure that any consultants identified by the city administrator as needing to file statements of economic interests submit the forms as soon as possible.

*City's Action: No action taken.*

The city did not address this recommendation in its August 2012 response.



**Recommendation 3.1.a—See pages 60—68 of the audit report for information on the related finding.**

To address the structural deficit in its general fund, the city should seek long-term solutions to balance the general fund's expenditures and revenues and lessen its reliance on transfers from other city funds. These solutions could include revenue increases, such as the proposed increased and new parcel tax, as well as looking for ways to reduce expenditures.

*City's Action: Partially implemented.*

The city states that in addition to the 20 percent reduction in its general fund expenditures reflected in the 2012–13 fiscal year budget, a subsequent budget amendment further reduced general fund spending by 6 percent. Additionally, the city indicates considering other actions, including working with key stakeholders in the business community to develop a comprehensive long-term revenue plan for the city's general fund and expects to present a proposal to city council by December 2012.

**Recommendation 3.1.b—See pages 68—70 of the audit report for information on the related finding.**

The city should clearly present the general fund structural deficit to the city council and the public in a budget that includes narrative and summary information to help users understand the city's budget process and its priorities and challenges, and that incorporates the elements for improved budgeting practices recommended by the Government Finance Officers Association (GFOA).



*City's Action: No action taken.*

- ➡ The city did not address this recommendation in its August 2012 response.

**Recommendation 3.2.a—See pages 71—73 of the audit report for information on the related finding.**

To better guide its budget preparation and improve transparency, the city should develop budget policies, particularly for long-term planning, that incorporate the elements that the GFOA recommends and make these policies available to the public on its Web site.

*City's Action: No action taken.*

- ➡ The city did not address this recommendation in its August 2012 response.

**Recommendation 3.2.b—See pages 68 and 69 of the audit report for information on the related finding.**

The city should ensure that its budgets include the information required in the city code.

*City's Action: No action taken.*

- ➡ The city did not address this recommendation in its August 2012 response.

**Recommendation 3.2.c—See pages 72 and 73 of the audit report for information on the related finding.**

The city should improve the monitoring of expenditures against the approved budget by establishing a centralized process to regularly monitor and report to the city administrator and the city council on the status of the budget.

*City's Action: Partially implemented.*

The city instituted quarterly budget reports to the city council beginning in May 2012. The city states that the budget presentation to city council outlined the budget requirements, process, and contents and reported the status of revenues and expenditures for the first quarter. The next quarterly budget report was scheduled for a September 2012 city council meeting. However, the city did not address whether it has developed a process for city executives to regularly report the budget status of their departments to the city administrator.

**Recommendation 4.1—See pages 76—80 of the audit report for information on the related finding.**

To ensure that it issues debt when doing so is in the best interests of the city and is consistent with its long-term financial goals, the city should establish a comprehensive debt policy that includes the elements that the GFOA recommends and make the debt policy it establishes available on its Web site.

*City's Action: No action taken.*

- ➡ The city did not address this recommendation in its August 2012 response.

**Recommendation 4.2—See pages 76—80 of the audit report for information on the related finding.**

To ensure that the city council and public are well informed regarding proposed debt decisions, the city should provide summary information that clearly explains the costs, risks, and benefits related to the proposed decisions in its agenda packets, and should provide these in advance on its Web site.



*City's Action: No action taken.*

The city did not address this recommendation in its August 2012 response.



**Recommendation 4.3.a—See pages 98 and 99 of the audit report for information on the related finding.**

To ensure that it can demonstrate sufficient analysis and provide justification for its decisions on significant energy-related transactions, the city should develop an integrated energy strategy that examines all elements of its energy needs, sources, and objectives.

*City's Action: No action taken.*

The city did not address this recommendation in its August 2012 response.



**Recommendation 4.3.b—See pages 98 and 99 of the audit report for information on the related finding.**

To ensure that it can demonstrate sufficient analysis and provide justification for its decisions on significant energy-related transactions, the city should create a formal process and guidelines that include the following: identifying the benefits and risks of proposed transactions, quantifying the benefits and risks of proposed transactions, evaluating and comparing proposed transactions against alternative proposals, quantifying the impact of proposed transactions on short-term and long-term rates paid by the city's energy customers, seeking an independent validation of the fair market value of proposed transactions, and documenting and communicating the findings of the evaluation process to the city council.

*City's Action: No action taken.*

The city did not address this recommendation in its August 2012 response.



**Recommendation 4.4—See page 95 of the audit report for information on the related finding.**

If the city plans to continue to rely on the advice of its consultants when entering significant energy-related transactions, it should develop a process for the consultants to provide written documentation that would enable the city to satisfy the process and guidelines outlined in 4.3.a and 4.3.b above.

*City's Action: No action taken.*

The city did not address this recommendation in its August 2012 response.



**Recommendation 4.5—See pages 104—106 of the audit report for information on the related finding.**

To minimize the continuing financial losses on the two currently outstanding interest rate swaps, the city should develop a clear process for deciding how it will terminate these swaps based on the cost and future risk to the city.

*City's Action: No action taken.*

The city did not address this recommendation in its August 2012 response.



**Recommendation 4.6.a—See pages 99—104 of the audit report for information on the related finding.**

To ensure that any future decisions to enter into interest rate swaps are carefully considered, the city should develop and follow a process that thoroughly analyzes the risks and benefits of the potential swap transaction.

*City's Action: No action taken.*

- ➡ The city did not address this recommendation in its August 2012 response.

**Recommendation 4.6.b—See pages 99—104 of the audit report for information on the related finding.**

To ensure that any future decisions to enter into interest rate swaps are carefully considered, the city should specifically disallow the use of derivatives for speculative purposes and should require the retention of the documents and analyses that support the decision to enter into the swap.

*City's Action: No action taken.*

- ➡ The city did not address this recommendation in its August 2012 response.

# Physical Therapy Board of California

## Although It Can Make Improvements, It Generally Processes Complaints and Monitors Conflict-of-Interest Requirements Appropriately

### REPORT NUMBER 2011-119, ISSUED JUNE 2012

This report concludes that one of the Physical Therapy Board of California's (physical therapy board) expert consultants has served as the in-house consultant since approximately 2003, performing cursory reviews of certain complaints before they may be referred to other expert consultants in the field. Although this individual has served in this capacity for approximately nine years, the physical therapy board has not tried to hire a state employee to fulfill this function at a reduced cost. We believe that the physical therapy board may be able to save approximately \$28,000 to \$35,000 annually if it can hire a state physical therapy consultant at existing state rates to perform the same work as its in-house consultant. The physical therapy board also lacks a process to formally evaluate its in-house or other expert consultants' performance, which limits its ability to demonstrate that it maximized the efficacy of the nearly \$95,000 it spent on expert consultants in fiscal year 2010–11.

In addition, we found that the Department of Consumer Affairs (Consumer Affairs) does not ensure that members of its boards participate in required board member orientation, nor does it ensure all necessary employees attend required ethics training. We also found that two former board members submitted their statements of economic interests significantly after state deadlines. When board members do not submit these statements in a timely manner, the public and the board members themselves may be unaware of potential conflicts of interest that may disqualify the board members from dealing with particular issues that come before the board.

However, our testing indicates that the physical therapy board appropriately investigates complaints and imposes discipline. In addition, we found that the physical therapy board's relationships with professional organizations are appropriate. Finally, we found that the physical therapy board complies with the agenda, public-comment, and closed-session requirements of the Bagley-Keene Open Meeting Act.

In the report, the California State Auditor (state auditor) made the following recommendations to Consumer Affairs and the physical therapy board. The state auditor's determination regarding the current status of recommendations is based on Consumer Affairs' and the physical therapy board's responses to the state auditor as of December 2012.

#### **Recommendation 1.1—See pages 17—20 of the audit report for information on the related finding.**

The physical therapy board should explore the feasibility of establishing a state position to perform the duties of its current in-house consultant at a reduced cost.

#### ***Physical Therapy Board's Action: Pending.***

The physical therapy board reported that it is attempting to establish a civil service position to perform the duties of its current in-house consultant. However, the physical therapy board stated that this is an involved and lengthy process that it does not expect to complete until July 2015. As an interim solution, the physical therapy board stated that it is considering negotiating a new contract at a reduced rate when the current contract with the in-house consultant expires in March 2013.

#### **Recommendation 1.2—See pages 20 and 21 of the audit report for information on the related finding.**

To make certain that it provides effective services to consumers, the physical therapy board should develop a means of formally evaluating its expert consultants against performance measures and benchmarks. Furthermore, the physical therapy board should conduct these evaluations regularly and document them fully.

***Physical Therapy Board's Action: Fully implemented.***

The physical therapy board developed formal policies and procedures to evaluate the performance of its in-house and other expert consultants in December 2012 and July 2012, respectively. These procedures were designed to evaluate expert consultants' productivity and quality of work product, among other attributes. The policies require the in-house consultant to be evaluated at least annually and other expert consultants to be evaluated every time they provide a service.

**Recommendation 1.3—See pages 22—24 of the audit report for information on the related finding.**

Consumer Affairs should establish procedures for ensuring that board members attend board member orientation and that those individuals and other designated employees receive all required ethics training. In addition, Consumer Affairs should adhere to the record retention period of five years specified by law for the certificates documenting that designated employees received ethics training.

***Consumer Affairs' Action: Partially implemented.***

Consumer Affairs agrees with this recommendation and reported that it is currently implementing an ongoing process of reviewing its files to confirm that its board members attend board member orientation and that those individuals and other designated employees receive all required ethics training. If Consumer Affairs does not have documentation that board members and other designated employees completed all applicable training, it will notify those individuals that they need to comply with the mandatory training requirements or provide evidence that they have already attended all applicable training. Consumer Affairs also reported that it will retain documentation that designated employees received all mandatory training, including ethics training, for five years.

**Recommendation 1.4—See pages 24 and 25 of the audit report for information on the related finding.**

To ensure that board members disclose in a timely manner potential conflicts of interest on their Form 700s, the physical therapy board should notify Consumer Affairs' filing officer promptly when board members are appointed or when they indicate that they intend to leave office.

***Physical Therapy Board's Action: Fully implemented.***

The physical therapy board has developed procedures that direct its personnel liaison to notify Consumer Affairs' filing officer within 10 business days of board members assuming or leaving office.

# California State Athletic Commission

## Improper Overtime Payments (Case I2009-1341)

### REPORT NUMBER I2012-1, CHAPTER 3, ISSUED DECEMBER 2012

This report concludes that the California State Athletic Commission (athletic commission) overpaid a total of \$118,650 to 18 athletic inspectors from January 2009 through December 2010 because it inappropriately paid them an hourly overtime rate rather than an hourly straight-time rate for the work they performed.

In the report, the California State Auditor (state auditor) made the following recommendations to the athletic commission. The state auditor's determination regarding the current status of recommendations is based on the athletic commission's response to the state auditor as of December 2012.

#### **Recommendation 1—See pages 18—22 of the investigative report for information on the related finding.**

The athletic commission immediately should cease paying the 18 athletic inspectors discussed in the report an overtime rate for work they perform and inform all athletic inspectors that it will compensate them at the classification's straight-time rate unless their work meets the criteria for receiving overtime under the Fair Labor Standards Act of 1938.

#### ***Athletic Commission's Action: Fully implemented.***

The athletic commission ceased paying overtime to the employees in October 2012. It is working with the Department of Consumer Affairs to recoup overpayments that it made the last three years.

#### **Recommendation 2—See pages 22 and 23 of the investigative report for information on the related finding.**

The athletic commission should make greater efforts to broaden its hiring and increase the number of applicants who are not full-time state employees by posting hiring announcements at locations where the athletic commission has a presence, such as gyms and venues at which it holds events.

#### ***Athletic Commission's Action: Pending.***

The athletic commission is exploring options to broaden the applicant pool for the athletic inspector classification.



# General Obligation Bonds

## The Departments of Water Resources and Finance Should Do More to Improve Their Oversight of Bond Expenditures

### REPORT NUMBER 2010-117, ISSUED MAY 2011

This report concludes that the Department of Water Resources (Water Resources) demonstrated effective oversight of general obligation bonds, but it could improve in certain areas. During our review of a sample of 10 projects, we noted that Water Resources made appropriate decisions when awarding bond funds and making payments for project activities. However, for two of the 10 projects, Water Resources could not demonstrate that it performed site visits or took other steps to ensure the projects achieved their expected outcomes. We also found that Water Resources lacks a documented review process to ensure information posted to the Bond Accountability Web site is correct. Our review of the Web site revealed instances where Water Resources posted inaccurate award information for certain projects and in some cases did not post any information at all.

We also found that the Department of Finance (Finance) should do more to ensure transparency and accountability for bond spending related to the general obligation bonds approved by voters in November 2006 to fund the State's Strategic Growth Plan. The former governor's executive order from January 2007 required Finance to establish a Bond Accountability Web site that was to include information on the amounts spent on each bond-funded project. However, Finance's approach to establishing the Web site required departments to post information on the amounts awarded and not the amounts spent. By not providing the public with periodic information on the amounts spent for each project—to then compare against amounts awarded—the public lacks a way to measure each project's progress towards completion. In addition, Finance lacks a tracking process to ensure that state departments update the Bond Accountability Web site and describe the expected or realized benefits of bond-funded projects in terms the public can readily understand. Finally, we noted that the executive order requires state agencies to either contract with Finance for audits of bond expenditures or make alternative arrangements for audits with Finance's approval. However, as of late April 2011, Finance had issued audit reports on only three of the state agencies administering the general obligation bonds that support the State's Strategic Growth Plan, and none were of Water Resources.

In the report, the California State Auditor (state auditor) made the following recommendations to the Governor and the audited agencies. The state auditor's determination regarding the current status of recommendations is based on Water Resources' response as of June 2012 and Finance's response as of July 2011.

#### **Recommendation 1.1—See pages 22—27 of the audit report for information on the related finding.**

To ensure that its expenditures of bond funds achieve the intended purposes, Water Resources needs to strengthen its monitoring of project deliverables. For example, it should review the policies and practices of its various divisions, ensuring that periodic progress reports are obtained from grant recipients, and that final site visits document the results of the reviews performed.

#### ***Water Resources' Action: Fully implemented.***

In its one-year response, Water Resources provided evidence that it updated various policy manuals establishing expectations for conducting site visits and ensuring that deliverables are obtained. For example, Water Resources' division of flood management developed a desk reference manual that includes project close-out procedures and a checklist for staff to follow. Key aspects of this close-out process include ensuring and documenting that project objectives are met. Similarly, Water Resources' Division of Integrated Regional Water Management developed written procedures establishing expectations for conducting site visits and specifying items to evaluate during such visits. Water Resources also provided examples of documented site visits it had performed.

**Recommendation 1.2—See pages 31—34 of the audit report for information on the related finding.**

To provide the public with accurate and complete information on the bond-funded projects it administers, Water Resources should develop and consistently use a formalized, documented review process that will provide greater assurance that project information posted to the Bond Accountability Web site is regularly updated and contains accurate information.

***Water Resources' Action: No action taken.***

➔ In its one-year response, Water Resources indicated that it had implemented our recommendation but did not provide evidence to substantiate its assertion. We requested Water Resources provide evidence of a systemic and documented review process for information posted to the Bond Accountability Web site. Specifically, we asked Water Resources to provide evidence that its management had reviewed and approved the information posted for three projects listed on the Bond Accountability Web site. Water Resources was unable to provide documentary evidence of these approvals.

**Recommendation 1.3—See pages 36—42 of the audit report for information on the related finding.**

To enhance transparency and accountability regarding the State's use of general obligation bond funds, the governor should require administering agencies to report actual amounts spent on bond funded projects and update the expenditure information at least semiannually.

***Governor's Action: Unknown.***

We are unaware of any additional guidance issued by the Governor's Office.

**Recommendation 1.4.a—See pages 36—42 of the audit report for information on the related finding.**

To enhance the value of the Bond Accountability Web site, Finance should require administering agencies to provide information about the actual amounts of bond funds spent on posted projects at least semiannually.

***Finance's Action: No action taken.***

➔ Finance does not intend to implement this recommendation. In its 60-day update to the audit, Finance stated that its current practice requires state departments and agencies to post the amounts awarded for specific projects on the Bond Accountability Web site. Finance further explained its expectation that state departments and agencies update a project's awarded amount with actual expenditures if there is a difference once the project is complete. Finance maintains that its current policies comply with the former governor's executive order. Further, Finance questions the benefits of this recommendation and stated that it would be costly for many state departments and agencies to implement. Finance did not provide a six-month or one-year response to the audit.

**Recommendation 1.4.b—See pages 42—45 of the audit report for information on the related finding.**

To enhance the value of the Bond Accountability Web site, Finance should develop a tracking and review process to periodically assess the completeness of the project information posted to the Bond Accountability Web site. Such a process should include a review of whether state agencies are describing, in terms the public can easily understand, the expected or realized benefits of bond-funded projects.



*Finance's Action: No action taken.*

Finance does not intend to take any additional steps to implement this recommendation. In its 60-day update, Finance stated that it will continue to review state agencies compliance during department audits and during special project reporting compliance reviews. Finance explained that its audits include a review of whether state departments are appropriately reporting project information. Finance did not provide a six-month or one-year response to the audit.

**Recommendation 1.5—See pages 45—47 of the audit report for information on the related finding.**

To ensure that expenditures were consistent with bond laws and that the project achieved the intended benefits or outcomes agreed to when the project was originally awarded, Finance should conduct audits of, or approve and assure that, Water Resources and other agencies obtain audits of, Strategic Growth Plan (SGP) bond expenditures.

*Finance's Action: Partially implemented.*

In its 60-day update, Finance stated that since the audit was published, Finance has issued four additional audit reports, for a total of six SGP bond audit reports in fiscal year 2010–11. Additionally, Finance indicated that all state agencies administering SGP bonds have either entered into interagency agreements with Finance to conduct audits or have made arrangements with other entities, with the approval of Finance, to conduct the required audits. Accordingly, Finance intends to continue to conduct audits as required by the former governor's executive order. Finance's 60-day update did not provide any additional material to corroborate its assertions. Finance did not provide a six-month or one-year response to the audit.



# Department of Housing and Community Development

## Awards of Housing Bond Funds Are Appropriate, but Cash Balances Are High and Monitoring Continues to Need Improvement

### REPORT NUMBER 2012-037, ISSUED OCTOBER 2012

This report concludes that the Department of Housing and Community Development (HCD) and the California Housing Finance Agency generally awarded funds in a timely manner and complied with legal requirements for making awards. However, HCD requested, and the Department of Finance (Finance) recommended, bond sales that were in excess of its cash needs at a time when the State's credit rating was declining and interest-rate volatility was high. As a result, the State paid as much as \$49 million in interest annually on the idle capital while the State was facing cash shortfalls.

Nevertheless, without these bond proceeds, the sustainability of certain housing bond programs likely would have been at risk. For most of HCD's housing bond programs, private lenders and banking institutions provide financing to sponsors, comprising entities qualified to construct or manage housing developments, for the construction of housing projects. Once the sponsor successfully completes the housing project, the sponsor uses its HCD award to repay the construction loan. Various state officials explained that key stakeholders cited significant concerns regarding the State's ability to fund these awards given the economic crisis at the time. In fact, state officials believed that without selling bonds in excess of immediate cash needs, and thereby demonstrating to the financial institutions that the State had the ability to fund the awards used by sponsors to repay the construction loans, many of the housing bond programs would have been suspended, or halted altogether. Thus, the reasons for the excessive bond sales appear to have merit.

Additionally, HCD did not always adhere to controls established for its CalHome and Building Equity and Growth in Neighborhoods (BEGIN) programs. For example, as we reported in November 2009, HCD still is not ensuring the recipients submit required status reports for its CalHome program. Further, we identified that HCD needs to improve its monitoring efforts during the period following payment up to the completion of all contract requirements. For instance, HCD had not finalized and implemented on-site monitoring procedures for its BEGIN program.

In the report, the state auditor made the following recommendations to HCD and Finance. The state auditor's determination regarding the current status of recommendations is based on HCD's and Finance's responses to the state auditor as of December 2012.

#### **Recommendation 1—See pages 16 and 17 of the audit report for information on the related finding.**

To ensure that it does not exceed the maximum amount specified in state law for administrative costs for the BEGIN Program, HCD should continue to reevaluate, as appropriate, its administrative support costs projection and continue to monitor its future costs.

#### ***HCD's Action: Fully implemented.***

HCD currently forecasts all costs for the life of the program and has a monitoring process to inform management of the need to adjust program administration to keep costs within statutory requirements. HCD indicated that it will continue to re-evaluate its administrative support cost projections and continue to monitor actual program costs. As such, HCD explained that it will maintain documentation of these business practices as needed.

**Recommendation 2—See pages 19—23 of the audit report for information on the related finding.**

Going forward, to the extent that Finance or HCD believes the State needs to issue bonds in excess of cash needs, it should document an analysis demonstrating the appropriateness of the bond sale amount and the circumstances.

***HCD's Action: Fully implemented.***

HCD stated that it agrees with our recommendations and will fully document any special circumstance that may require bonds to be issued in excess of the immediate cash need. HCD stated that Finance requests a Bond Cash Flow Analysis (drill) twice per year. As part of HCD's processes and procedures for this drill, HCD indicated that documentation is available that demonstrates whether or not it recommends a bond sale. HCD explained that it will now document the considerations and circumstances should Finance's final bond decision not match HCD's bond recommendation. According to HCD, Finance has the full authority over this process and makes the final decision on whether or not a bond sale is initiated. HCD stated that as the need arises, it will document the decisions and considerations made during these drills and that it will maintain the documentation and present the material when necessary.

***Finance's Action: Fully implemented.***

Finance stated that it agrees with our recommendation and explained that it has significantly increased the level of analysis that it conducts regarding the level of bond program cash needs by routinely surveying departments, analyzing usage rates, and assessing future demand. Finance indicated that it is retaining these analyses so that they will be available for any future audits.

**Recommendation 3.a—See pages 25 and 26 of the audit report for information on the related finding.**

HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by requiring staff to follow its procedures related to centrally tracking advances to sponsors under the CalHome Program.

***HCD's Action: Partially implemented.***

HCD stated that by March 2013, it will review and update all Proposition 1C and 45 CalHome disbursements through September 2012 in the centralized system to track and log advances to ensure current, complete, and accurate information. In addition, HCD explained that current processes for management approval and tracking advances have been implemented and were communicated to all appropriate staff on or about September 27, 2012. Further, a centralized tracking log has been developed and implemented for advance transactions. HCD stated that written policies regarding when and how staff is to update the tracking log have been developed but are currently under management review and not ready for finalization. HCD explained that management will continue to reiterate the importance of using these policies and procedures to ensure proper tracking.

**Recommendation 3.b—See pages 26—28 of the audit report for information on the related finding.**

HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by ensuring that it receives, reviews, and centrally tracks required status reports from sponsors under its CalHome and BEGIN programs.

***HCD's Action: Partially implemented.***

HCD explained that at the beginning of each quarter staff will contact their assigned sponsors via e-mail to request the required quarterly reports. HCD indicated that this will ensure that program staff are proactively requesting the information and documenting the request. Upon receipt, HCD stated that staff will review and record the report in the established centralized tracking report file.

In those instances when a sponsor fails to submit a report, HCD asserted that the program manager will take steps to obtain the report and document the response in the file and the centralized tracking report. HCD also explained that the CalHome and BEGIN programs have developed procedures, currently under review by program management, which will give program managers the ability to assess sponsor quarterly and annual reporting compliance. HCD stated that it anticipates completion of the written procedures on or before May 31, 2013. HCD also indicated that monitoring of reporting compliance is a key performance indicator for both staff and management.

**Recommendation 3.c—See pages 28 and 29 of the audit report for information on the related finding.**

HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by, upon finalizing monitoring procedures for the BEGIN Program, ensure that staff implement and follow them.

***HCD's Action: Fully implemented.***

HCD has developed a written monitoring process, including a risk assessment tool and checklist to be used for the monitoring of BEGIN projects. HCD explained that it finalized and implemented this process during October 2012. Further, HCD stated that BEGIN staff completed training by the end of November 2012 and staff are currently applying the risk assessment tool to develop the monitoring schedule. HCD indicated that once each recipient has been given a final score, they will be entered on the monitoring spreadsheet and sorted to identify those recipients that are at higher risk. HCD implemented the monitoring plan in December 2012 and scheduled its first monitoring visit for January 2013.

**Recommendation 3.d—See page 29 of the audit report for information on the related finding.**

As it relates to selecting which sponsors to monitor, HCD should continue its efforts to monitor sponsors that receive awards of housing bond funds by adopting a risk-based, on-site monitoring approach for its CalHome and BEGIN programs. For the CalHome Program, HCD should evaluate the criteria in its risk assessment tool and require staff to use a centralized tracking log for on-site monitoring visits, which should indicate when findings are resolved.

***HCD's Action: Fully implemented.***

The BEGIN Program has developed a written monitoring process, including a risk-assessment tool and checklist to be used for the monitoring of BEGIN projects and it implemented the process in December 2012. Additionally, HCD explained that CalHome management has evaluated and approved the criteria in its risk assessment tool. Further, HCD stated that the CalHome staff and management team has developed and implemented a centralized tracking log, which will be maintained by staff for all audit findings and monitored by CalHome management to ensure resolution to findings.



# Intellectual Property

## An Effective Policy Would Educate State Agencies and Take Into Account How Their Functions and Property Differ

### REPORT NUMBER 2011-106, ISSUED NOVEMBER 2011

Intellectual property typically consists of copyrights, trademarks, patents, and trade secrets. In November 2000, the California State Auditor (state auditor) issued a report titled *State-Owned Intellectual Property: Opportunities Exist for the State to Improve Administration of its Copyrights, Trademarks, Patents, and Trade Secrets*—report number 2000-110 (2000 audit report). The 2000 audit report recommended the Legislature take steps to help state agencies manage and protect the State's intellectual property.

This report concludes that the State has not enacted a statutory framework, nor has it implemented the recommendations made in the 2000 audit report or otherwise provided guidance to state agencies regarding the management and protection of intellectual property. The four state control agencies we spoke to—the Department of Finance, the Department of General Services (General Services), the State Controller's Office, and the California Technology Agency—generally do not provide policies or guidance to other state agencies regarding the management and protection of intellectual property because they do not believe that they are responsible for providing this type of guidance. However, more than half of the state agencies that responded to our survey about intellectual property stated that the State should establish statewide guidance for managing and protecting intellectual property. Moreover, the four state agencies we visited—the Department of Transportation (Caltrans), Department of Food and Agriculture (Food and Agriculture), California Energy Commission (Energy Commission), and Department of Health Care Services (Health Care Services)—had only limited written policies and instead generally relied on informal practices to manage and protect their intellectual property. To move forward, the State will need to clearly articulate the goals of any policy related to intellectual property. We believe that an effective policy would educate state agencies on their intellectual property rights and would be flexible and take into account that state agencies perform different functions and work with different types of intellectual property.

In the report, the state auditor made the following recommendations to Caltrans, Food and Agriculture, Energy Commission, Health Care Services, the Legislature, and the governor. The state auditor's determination regarding the current status of recommendations is based on the agencies' responses to the state auditor as of November 2012.

#### **Recommendation 1.1—See pages 19—21, 31—32, and 35—40 of the audit report for information on the related finding.**

Caltrans, the Energy Commission, Food and Agriculture, and Health Care Services should put in writing those policies and procedures related to intellectual property that they believe are necessary and appropriate to enable their staff to identify, manage, and protect their intellectual property.

#### ***Caltrans' Action: Fully implemented.***

In June 2012 Caltrans issued a written policy related to ownership and use of its intellectual property. Further, Caltrans stated that it issued interim guidelines in October 2012 to assist its managers and employees to better manage and protect Caltrans' intellectual property. Finally, Caltrans stated that it will modify its interim guidelines as its program develops and General Services issues direction per Assembly Bill 744 (AB 744) [Chapter 463, Statutes of 2012], which was signed by the governor in September 2012.

***Energy Commission's Action: Fully implemented.***

The Energy Commission updated its policies and procedures to educate staff about intellectual property and how to protect it. It completed the policies and procedures in January 2012, and the Energy Commission stated that it made the information available to all staff on its intranet.

***Food and Agriculture's Action: Fully implemented.***

Food and Agriculture issued intellectual property policy and guidelines in July 2012.

***Health Care Services' Action: No action taken.***

- ➔ Health Care Services indicated that it has not yet implemented the recommendation because of other high priority projects and staff vacancies. However, Health Care Services stated that pursuant to AB 744 it will coordinate with General Services to track and manage its intellectual property.

**Recommendation 1.2—See page 20 of the audit report for information on the related finding.**

Food and Agriculture should ensure that it has developed intellectual property terms and conditions that are appropriate for the types of agreements into which its contracts office enters.

***Food and Agriculture's Action: Fully implemented.***

Food and Agriculture issued intellectual property policy and guidelines in July 2012. The policy specifies responsibility for developing and registering Food and Agriculture's intellectual property including language in contracts that is appropriate and necessary.

**Recommendation 1.3—See pages 21 and 22 of the audit report for information on the related finding.**

The Energy Commission should take the necessary steps to strengthen its royalty process to ensure that it receives the proper amounts from all contractors that owe it royalties.

***Energy Commission's Action: Fully implemented.***

The Energy Commission stated that it has modified its annual Public Interest Energy Research (PIER) royalty letter to require a response and added language to its PIER solicitations indicating that bidders who have not responded to the royalty repayment letter may be screened out from participating in future PIER funding opportunities. The Energy Commission also stated that it amended a contract with the State Controller's Office to include review of PIER royalty payments and that those reviews are underway. The Energy Commission stated it has drafted new PIER terms and conditions, which require certification that the royalty amount paid is correct. Finally, the Energy Commission stated that it hired a contractor to perform follow-up calls and independent market assessment on PIER researchers who might have sold intellectual property products and not yet paid royalties and to identify current PIER researchers that will be required to pay future royalties. The Energy Commission expected work on this contract to begin in December 2012.

**Recommendation 1.4.a—See pages 25—28 of the audit report for information on the related finding.**

The Legislature and the governor should consider developing a statewide intellectual property policy that educates state agencies on their intellectual property rights without creating an administrative burden. Specifically, this policy should provide guidance to agencies that will give them the understanding necessary to identify when potential intellectual property may exist, including when contractors' work may result in intellectual property, and that will provide them with specific information on intellectual property protections.



***Legislative Action: Legislation partially implemented.***

AB 744 requires General Services to develop an outreach campaign informing state agencies of their rights and abilities concerning intellectual property. However, the outreach campaign requirement is specific to intellectual property state employees create and does not mention contractors.

**Recommendation 1.4.b—See pages 25—28 of the audit report for information on the related finding.**

The Legislature and the governor should consider developing a statewide intellectual property policy that educates state agencies on their intellectual property rights without creating an administrative burden. Specifically, this policy should recognize that not all agencies have the same needs and that a one-size-fits-all approach may not be feasible. An effective policy should provide agencies with flexibility regarding ownership of intellectual property rights.

***Legislative Action: Legislation enacted.***

AB 744 requires General Services to develop various samples and other information for state agencies to consider for owning and managing intellectual property. AB 744 does not require General Services to develop a strict policy that state agencies must follow and in that respect provides the flexibility called for.

**Recommendation 1.4.c—See pages 25—28 of the audit report for information on the related finding.**

The Legislature and the governor should consider developing a statewide intellectual property policy that educates state agencies on their intellectual property rights without creating an administrative burden. Specifically, this policy should have as one of its primary goals the promotion of the greatest possible public benefit from intellectual property the State creates or funds.

***Legislative Action: Legislation enacted.***

AB 744 requires General Services to develop various samples and other information for state agencies to consider for owning and managing intellectual property. In passing AB 744, the Legislature declared its intent that the rights of state agencies and departments to track and manage intellectual property created with any state funds shall be interpreted so as to promote the benefit to the public.

**Recommendation 1.4.d—See pages 25—28 of the audit report for information on the related finding.**

The Legislature and the governor should consider developing a statewide intellectual property policy that educates state agencies on their intellectual property rights without creating an administrative burden. Specifically, this policy should recognize that although additional revenue may be a potential benefit of the State's intellectual property, it is not the only benefit, nor should it be the driving force behind a state policy. However, the policy should provide guidance for identifying valuable intellectual property and how to commercialize it, if appropriate.

***Legislative Action: Legislation enacted.***

AB 744 requires General Services to develop an outreach campaign to educate state agencies about their rights and abilities concerning intellectual property, to develop factors that state agencies should consider when deciding whether to sell their intellectual property or license it, and to develop sample invention assignment agreements to secure the rights to potentially patentable intellectual property.

**Recommendation 1.4.e—See pages 25—28 of the audit report for information on the related finding.**

The Legislature and the governor should consider developing a statewide intellectual property policy that educates state agencies on their intellectual property rights without creating an administrative burden. Specifically, this policy should establish the minimum rights agencies should obtain for intellectual property developed by its contractors.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 1.5—See pages 28 and 43—51 of the audit report for information on the related finding.**

If the Legislature and governor believe it would be valuable to understand the amount of intellectual property the State holds on an ongoing basis, they should consider establishing a mechanism to track the State's intellectual property.

***Legislative Action: Legislation enacted.***

AB 744 requires General Services, beginning January 2015, to track intellectual property generated by state employees or with state funding. General Services must develop a database to track intellectual property that includes certain information, such as date of creation and sources of funding. General Services is to update the database every three years.

## Department of General Services

### The Division of the State Architect Lacks Enforcement Authority and Has Weak Oversight Procedures, Increasing the Risk That School Construction Projects May Be Unsafe

#### REPORT NUMBER 2011-116.1, ISSUED DECEMBER 2011

This report concludes that the Department of General Services' (General Services) Division of the State Architect (division) is unable to certify that a large number of completed school construction projects meet requirements in the Field Act, a law designed to protect the safety of pupils, teachers, and the public. The division reports that over 16,000 projects remain uncertified. Elements of the act hamper the division's ability to enforce the certification requirements. For example, the act allows school districts to occupy uncertified projects and does not give the division the express authority to penalize school districts that do not comply with certification requirements. Further, the division infrequently uses its authority to stop construction of projects when it determines there is a risk to public safety. In addition, the division lacks a clear system for classifying uncertified projects, increasing the risk that it will miscommunicate the true risks associated with uncertified projects and that efforts to strategically follow up on these projects will be impeded.

We also found that the division's oversight of project construction is not effective. The division lacks a process for planning oversight it will perform, and in some cases could not demonstrate that it provided adequate field oversight. We found examples of projects with an estimated cost of up to \$2.2 million that had no evidence of a visit by the division's field staff. Further, the division relies on project inspectors to ensure that projects are constructed according to approved plans, but these inspectors are employees or contractors of the school districts, which increases the risk of improper influence and the division has not implemented robust strategies to mitigate this risk. Additionally, the division is not always able to approve project inspectors for work before the beginning of construction as the Field Act requires. Also, the division does not complete field oversight of school construction in the areas of fire and life safety and accessibility, raising the risk that safety issues in these areas will go uncorrected. Finally, the division lacks performance measures that could help it to improve its field oversight and certification of efforts.

In the report, the California State Auditor (state auditor) made the following recommendations to General Services and the Legislature. The state auditor's determination regarding the current status of recommendations is based on General Services' response to the state auditor as of December 2012.

#### **Recommendation 1.1.a—See pages 16—18 of the audit report for information on the related finding.**

To ensure public safety and provide public assurance that school districts construct projects in accordance with approved plans, the department, in conjunction with the division, should pursue legislative changes to the Field Act that would prohibit occupancy in cases in which the division has identified significant safety concerns.

#### ***General Services' Action: Pending.***

According to General Services, the State Architect determined that the division could achieve the objective of this recommendation through an inspection card system similar to one used in municipalities throughout the State. It indicated that such a system would allow for the verification of structural integrity and fire and life safety at the completion of each phase of a project and should result in timely certification upon completion of project construction. The division expects to implement the inspection card system in April 2013.

**Recommendation 1.1.b—See pages 16—18 of the audit report for information on the related finding.**

To ensure public safety and provide public assurance that school districts construct projects in accordance with approved plans, the Legislature should consider implementing additional penalties for school districts that do not provide all required documents.

***Legislative Action: Legislation proposed.***

Senate Bill 1271 (as amended) of the 2011–12 Regular Legislative Session, if enacted, would have required General Services to convene a workgroup or continue to use an existing workgroup to develop and adopt standards regarding the seismic safety of schools, make recommendations to the Legislature on ways to amend the Field Act to make it more effective, and report the recommendations of the workgroup to the Senate Select Committee on Earthquake and Disaster Preparedness, Response and Recovery by July 1, 2013. The bill was held in the Assembly Committee on Appropriations.

**Recommendation 1.2—See pages 18—20 of the audit report for information on the related finding.**

To better use the enforcement tools at its disposal, the division should continue and expand its use of both orders to comply and stop work orders, as defined in its regulations. The division should also develop performance measures to assess the success of any efforts it makes to address safety concerns and reduce the number of uncertified projects.

***General Services' Action: Partially implemented.***

The division updated its policies for stop work orders and orders to comply and conducted trainings for staff on the new policies in the fall of 2012. According to General Services, the new policies will be effective January 1, 2013, and at that time the division's regional office managers will be required to record the issuance of stop work orders and their resolution, and the division's headquarters staff will be required to monitor regional office data entries and activities with respect to stop work orders.

**Recommendation 1.3—See pages 20—23 of the audit report for information on the related finding.**

To ensure that it clearly justifies the reasons a project's noted issues merit a particular classification, the division should either modify its current policies regarding classifying types of uncertified projects or develop new policies, including requiring documentation of the rationale behind project-specific classifications. It should use its classifications to prioritize its efforts to follow up on uncertified projects based on risk and to better inform the public regarding the reasons it has not certified projects.

***General Services' Action: Partially implemented.***

In December 2012 the division conducted training for staff on changes to its procedures for project certification letters, which will be effective January 2013. In that training, the division outlined three certification letters it will use: one to indicate certified projects, a second to indicate projects not receiving certification because the division needs additional documentation, and a third to indicate projects not receiving certification because the division has noted deficiencies in the project. General Services said that for projects that cannot be certified due to missing documentation, the division will specify in its letter the required documents and the steps required to obtain certification. In addition, the division will no longer close project files for projects with outstanding noncompliance issues and will monitor the projects until these noncompliant conditions are resolved. General Services' response did not outline how the division would use these new classifications to prioritize follow-up efforts or inform the public.

**Recommendation 1.4—See pages 23 and 24 of the audit report for information on the related finding.**

To reduce the number of uncertified projects, the division should implement initiatives to follow up with school districts on uncertified projects. Those initiatives should include, at a minimum, regularly sending each district a list of its uncertified projects and assessing the success of the division's follow-up efforts.

***General Services' Action: Partially implemented.***

General Services stated that the division has implemented an outreach plan that includes regular communication with school districts about uncertified projects. In April 2012 the State Architect sent school superintendents a letter that advised them of the outreach effort. According to that letter, the State Architect plans to send letters to all school districts with uncertified school construction projects. The letter also said that each notification will include the names of the uncertified projects and the original closing letters that state why the State Architect was unable to certify the projects. According to General Services, beginning on June 1, 2012, the division sent out copies of the original closing letters for more than 9,000 uncertified projects and will continue with outreach efforts for the remaining uncertified projects. The division also plans to develop correspondence procedures that ensure regular follow-up with districts that have uncertified projects. The division stated it would develop correspondence procedures by June 2013 and provide districts with original closing letters by September 2013. Finally, according to General Services, the division's outreach efforts have resulted in the reduction of uncertified projects from 16,386 to 14,334, and the division has conducted site visits of each uncertified project that has evidence of unresolved safety deficiencies.

**Recommendation 2.1.a—See page 28 of the audit report for information on the related finding.**

To ensure it is providing adequate oversight of school district construction projects, the division should develop robust procedures for monitoring inspectors' submission of semi-monthly reports. The division should also maintain all semi-monthly reports in its project files.

***General Services' Action: Partially implemented.***

The division updated its project-tracking system to record the date of the most recent semi-monthly report and conducted staff training on the procedures for receiving, reviewing, and documenting the filing of semi-monthly reports in November 2012. The division also issued revised guidance in December 2012 to inspectors on filing semi-monthly reports, including a list of who must receive the report and a report template. Finally, the division indicated that there will be additional training in January 2013 on monitoring the filing of semi-monthly reports.

**Recommendation 2.1.b—See pages 28 and 29 of the audit report for information on the related finding.**

To ensure it is providing adequate oversight of school district construction projects, the division should develop and document an overall strategy that establishes specific expectations for conducting site visits and monitoring construction. The division should then record and compare its actual visits and monitoring efforts to its planned actions. The division should document explanations for any deviations from its plans.

***General Services' Action: Partially implemented.***

The division conducted training in November 2012 on its objectives for conducting site visits based on project characteristics. For example, for new building construction the division expects to visit a project inspector every four to eight weeks. Additionally, the division has developed a monitoring tool in order to record actual site visits completed by its field engineers and to allow it to compare those visits to the number of site visits expected. According to General Services, the division is developing a two-phase staff training program that will include using the monitoring system to generate data on field activities and procedures for ensuring that site visit goals are met using the available data. The division expects to conduct the training in the first quarter of 2013.

**Recommendation 2.1.c—See pages 29 and 30 of the audit report for information on the related finding.**

To ensure it is providing adequate oversight of school district construction projects, the division should establish consistent criteria for entering data into its database on key aspects of projects, such as the dates for the start and end of construction.

***General Services' Action: Fully implemented.***

The division developed standard criteria for documenting the start and end dates of school construction projects and accordingly updated its guidelines for project inspectors in December 2012. The guidelines state, for example, that the inspector will use as the construction start date the date the contractor mobilizes on the project site to begin construction.

**Recommendation 2.2—See pages 31 and 32 of the audit report for information on the related finding.**

To mitigate risks arising from the relationship between inspectors, school districts, and project managers, the division should develop formal procedures and explicit directions for field engineers to ensure that they establish a presence on project sites and provide adequate oversight of inspectors during construction.

***General Services' Action: Partially implemented.***

In August 2012 the division conducted training on monitoring project inspector recordkeeping. A second training in November 2012 focused on documentation of field oversight activities, including site visit goals. According to General Services, additional training sessions will be completed by February 2013. These sessions will outline procedures for generating field status data to ensure adequate oversight of active construction projects.

**Recommendation 2.3—See pages 32 and 33 of the audit report for information on the related finding.**

To ensure that it approves inspectors prior to the start of project construction, the division should streamline its approval process by reviewing inspectors' workloads and past experience using the data it already maintains.

***General Services' Action: Partially implemented.***

General Services stated that the division has updated its electronic project-tracking system to report on inspector workloads and experience. According to General Services, the updates allow division field engineers to obtain data on an inspector's current workload and that information can inform decisions regarding inspector approval. General Services stated that the division is developing procedures for statewide staff training on this system update scheduled for the first quarter of 2013.

**Recommendation 2.4—See pages 33 and 34 of the audit report for information on the related finding.**

To ensure that certified inspectors are knowledgeable about current code requirements, the division should not excuse inspectors from required trainings and should improve its process for identifying expired certification exam scores. Further, the division should consistently follow and document its procedures for verifying the past employment of inspector applicants.

***General Services' Action: Fully implemented.***

In January 2012 the division updated its written policies regarding inspector certification. These policies directly state the specific training required for inspectors who are taking the certification exam and also state the number of years for which a partial exam score is valid. In addition, in January 2012 the division issued an updated policy regarding the verification and documentation



of an inspector candidate's past experience. The policy directs certification unit staff to verify a candidate's experience and indicates the way to document that experience. The division has developed experience verification forms that feature "Verified By" and "Date Verified" fields for completion by staff.

**Recommendation 2.5—See pages 35—37 of the audit report for information on the related finding.**

To ensure that it formally monitors inspectors' performance, the division should reestablish a process for evaluating inspectors that provides consistent documentation of performance. The division should make this information accessible to appropriate staff.

*General Services' Action: Partially implemented.*

General Services outlines a number of actions the division has taken to track inspector performance, including establishing a process for reviewing inspector recordkeeping, and enhancing its automated tracking system to allow field engineers to document project inspectors' completion of reporting duties throughout the duration of projects. Although these changes provide the division with additional information on inspector performance, General Services did not indicate when it would reestablish an inspector evaluation process.

**Recommendation 2.6—See pages 37 and 38 of the audit report for information on the related finding.**

To address areas in which its staff do not currently have expertise, the division should finalize its field pilot and take subsequent steps to ensure it has qualified staff to provide oversight of accessibility; fire and life safety; and the mechanical, electrical, and plumbing aspects of construction.

*General Services' Action: Partially implemented.*

General Services stated that the division revisited the results of the field pilot and determined that, based on the current statutory-based fee structure, sufficient resources are available only for oversight of structural safety, fire and life safety, and accessibility issues. General Services also said that to achieve the field pilot's objectives for enhanced oversight, the division is developing a training program that will increase the expertise of its field engineers in the fire and life safety elements of construction as well as accessibility compliance. Training is planned for the first quarter of 2013.

**Recommendation 2.7—See pages 38 and 39 of the audit report for information on the related finding.**

To better manage its construction oversight and close-out functions, the division should develop measures to assess those functions and it should periodically report the results to the public on its Web site.

*General Services' Action: Pending.*

General Services stated that the division has developed measurements and reporting for its field oversight program, including site visit activities and the rate of project certification. It also said, however, that the division is in the process of evaluating the data reported and correlating reporting procedures between offices to ensure consistent statewide reporting. Subsequently, the division will develop external reporting based on the results of this evaluation. General Services did not provide a timeline for completing these actions.

**Recommendation 2.8—See pages 40 and 41 of the audit report for information on the related finding.**

To address possible staffing problems, the division should use documented workload metrics to perform an assessment of its current staffing levels and determine its staffing needs. It should revisit the field pilot and make necessary changes to reflect its understanding of its current staffing situation.

***General Services' Action: Partially implemented.***

According to General Services, the division developed an automated statewide metric to measure its field oversight workload. The division used the metric to conduct an assessment of its staffing level which, according to General Services, is commensurate with the division's site visit goals. The division will conduct this review on a regular basis to reassess its staffing needs for oversight. Further, according to General Services, the division determined that, based on the current statutory-based fee structure, sufficient resources are available only for oversight of structural safety, fire and life safety, and accessibility issues. The division did not provide evidence of its staffing assessment.



## Department of General Services

### Strengthening the Division of the State Architect's Workload Management and Performance Measurements Could Help It Avoid Delays in Processing Future Increases in Workload

#### REPORT NUMBER 2011-116.2, ISSUED MAY 2012

This report concludes that the Division of the State Architect (division), within the Department of General Services (department) has been able to keep the amount of time plans wait for review—bin time—under six weeks primarily due to a decrease in workload. Should the division's workload return to previous levels, it will likely struggle to maintain this goal. Recently, the division was prevented from contracting for plan review and instead drew on staff from its construction oversight activities. Further, although the division has a goal for keeping bin time below six weeks, it does not have goals for how long it should take to review plans. Without a plan review time goal, the division has less assurance that it is reviewing plans efficiently and school districts' design professionals have little certainty about how long they should expect to wait for the division to return plans to them for correction.

Also, the division's monthly performance reports on the length of each phase of the plan approval process do not report clear or accurate information. For example, the division includes in its reports some projects for which no plan review activity has occurred because the applications were incomplete, counting the length of time it took to complete each phase as zero days. Finally, the division cannot provide assurance that it has received and approved all plan changes before the start of related construction. After the division approves plans, districts must submit changes to the division for review and approval before undertaking related construction. However, the division does not have a process to ensure that it has received and approved all relevant plan changes. If the division does not approve plan changes before construction, construction may not comply with building standards and risks being unsafe.

In the report, the California State Auditor (state auditor) made the following recommendations to the division. The state auditor's determination regarding the current status of recommendations is based on the division's response to the state auditor as of December 2012.

#### **Recommendation 1.1—See pages 21—23 of the audit report for information on the related finding.**

To better gauge the timeliness of its plan review and better communicate with design professionals, the division should develop goals for the time spent on the plan review phase, in the style of those used by the Office of Statewide Health Planning and Development, and measure and report its success at meeting these goals.

#### ***Division's Action: Pending.***

According to the department, the division is actively developing reports that measure anticipated and actual plan review finish dates. The department stated that the division is reviewing data to ensure the validity of the information and is preparing metrics on the success of meeting plan review goals. The division plans to publish this information in January 2013.

#### **Recommendation 1.2—See pages 23—25 of the audit report for information on the related finding.**

In order to avoid delays in plan review, the division should develop a policy that defines when it will expedite plan review using its statutory authority to contract for additional plan review resources.

***Division's Action: Partially implemented.***

On November 30, 2012, the division published a policy to provide guidance regarding when it will use consultants to conduct plan review of school projects. The policy states that the division will use consultants for plan review when the division is unable to meet the project owner's need for turnaround time, plan review cannot be accommodated in some other way, such as by transferring plans to another region, and resources exist for consultants. The policy outlines some steps the division will take to determine whether to use consultants, however, according to the division, it does not typically request that districts provide a turnaround time for projects. Further, the policy does not tie the division's use of consultants to any kind of metric, such as that which will be developed according to Recommendation 1.1.

**Recommendation 1.3.a—See pages 25—27 of the audit report for information on the related finding.**

To more accurately report on its plan review activities to stakeholders and provide relevant information to management, the division should provide current information on its performance, by phase, at the time of the reporting period.

***Division's Action: Pending.***

According to the department, the division will change its methodology to capture relevant information upon completion of each plan review phase in January 2013.

**Recommendation 1.3.b—See pages 25—27 of the audit report for information on the related finding.**

To more accurately report on its plan review activities to stakeholders and provide relevant information to management, the division should exclude zero values from its calculations related to projects that did not have activity in a particular phase.

***Division's Action: Fully implemented.***

The division no longer issues monthly plan review workload reports, but its monthly plan review scorecard excludes zero values by design. The report includes only projects with approved plans and thus every plan in the report will have completed each phase of the plan review process.

**Recommendation 1.3.c—See pages 25—27 of the audit report for information on the related finding.**

To more accurately report on its plan review activities to stakeholders and provide relevant information to management, the division should exclude projects from client phase calculations that were not returned to the division for back check within the division's deadlines.

***Division's Action: Pending.***

According to the department, the division changed its calculation of plan review processing times to use a maximum of 365 days for projects that have not been returned for back check. It said the division would begin using the new calculation in its November 2012 metrics' reports. However, the division's November 2012 plan review scorecard still included projects that had not begun back check within the division's one-year deadline.

**Recommendation 1.4.a—See pages 27—29 of the audit report for information on the related finding.**

To appropriately oversee changes to approved plans, the division should develop policies and procedures to ensure that it receives all relevant plan changes.

***Division's Action: Partially implemented.***

The division issued a revised interpretation of its regulations regarding construction changes. That interpretation outlined a process for design professionals to submit certain construction changes to the division for approval prior to the start of construction. However, the interpretation did not describe how the division intends to ensure it receives all relevant construction changes. According to the division, it is implementing a process for electronic submittal of construction change documents that will allow all involved parties access to information on the project. Additionally, the division states it is implementing a process to audit project inspector records, in part to ensure the division has received all construction changes requiring approval.

**Recommendation 1.4.b—See pages 27—29 of the audit report for information on the related finding.**

To appropriately oversee changes to approved plans, the division should develop policies and procedures to ensure that it reviews and approves all relevant plan changes before the start of related construction.

***Division's Action: Partially implemented.***

In a procedure adopted in November 2012, the division outlined its process for recording approval of plan changes. Specifically, the division's policy states it will retain a copy of approved changes as will the project inspector. The division will also require design professionals to attest to the fact that all changes to structural, access, or fire and life safety portions of a project have received division approval. Additionally, the division will require that project inspectors monitor changes to plans and notify design professionals if any changes appear to require division approval. However, as described in Recommendation 1.4.a, the division has not yet completed a process to ensure it receives all relevant construction changes prior to the start of related construction.

**Recommendation 1.4.c—See pages 27—29 of the audit report for information on the related finding.**

To appropriately oversee changes to approved plans, the division should develop policies and procedures to ensure that it documents its approval of all relevant plan changes.

***Division's Action: Fully implemented.***

In a procedure adopted in November 2012, the division outlined its process for recording approval of plan changes. Specifically, the division's policy states it will retain a copy of approved changes, as will project inspectors.

**Recommendation 1.5—See pages 29 and 30 of the audit report for information on the related finding.**

To ensure that the division performs a final review in all disciplines, the division should require and provide a means for recording final plan review of fire and life safety and access compliance-related work in the database.

***Division's Action: Pending.***

According to the department, the division is working with information technology staff to develop additional fields in its project database to capture final review dates. The division estimates it will complete this task in June 2013.

**Recommendation 1.6—See page 30 of the audit report for information on the related finding.**

To ensure that staff are current on building standards, the division should document its staff's participation in building standards update trainings by maintaining attendance rosters.

***Division's Action: Fully implemented.***

The division submitted to the state auditor instructions provided to staff via e-mail informing them that the division requires an attendance sheet be kept as a record of who attends trainings and that the division maintains this sheet in training records. Additionally, the division submitted an example of the attendance sheet used at a recent training.

# California Department of Transportation

## Its Poor Management of State Route 710 Extension Project Properties Costs the State Millions of Dollars Annually, Yet State Law Limits the Potential Income From Selling the Properties

### REPORT NUMBER 2011-120, ISSUED AUGUST 2012

This report concludes that the California Department of Transportation (Caltrans) has spent nearly \$22.5 million to repair the properties it owns between July 1, 2008, and December 31, 2011, which exceeds the rental income it collected by \$9.7 million. Caltrans charges the majority of the State Route 710 (SR 710) property tenants rents that are, on average, 43 percent below market rate. By doing so, we estimate that Caltrans has foregone \$22 million in rental income between July 1, 2007, and December 31, 2011. Further, our legal counsel advises us that generally Caltrans' rental of the SR 710 properties at below-market rates may constitute a prohibited gift of public funds.

Caltrans has spent an average of \$6.4 million per year on repairs to the SR 710 properties; however, it could not demonstrate that the repairs for many of the properties were reasonable or necessary. Caltrans maintains the SR 710 properties by either contracting directly with service providers or requesting that the Department of General Services (General Services) complete specific repairs. However, Caltrans did not always perform annual inspections to determine whether repairs were necessary. Furthermore, Caltrans often authorized repairs that far exceeded the properties' potential rental income. Also, General Services exerts insufficient oversight over several repair project cost areas. For example, General Services' construction unit does not properly monitor its labor charges. General Services also did not follow state law and policies governing purchases from small businesses. We found that the owner of a small business that does a large amount of business with General Services is related to the owners of two other small businesses that General Services made purchases from, and these companies with related owners bid against each other. Consequently, other qualified suppliers may not have had a fair opportunity to participate in the competitive solicitation process.

As of March 1, 2012, Caltrans estimated that the market value of the SR 710 parcels was \$279 million, with single- and multi-family residential parcels comprising \$238 million, or 85 percent, of the estimated market value. However, if the State were to deem these residential parcels as surplus and sell them in accordance with the state law known as the Roberti Bill, it could potentially receive only \$40 million, or 17 percent of their estimated market value. Further, if the SR 710 residential parcels were sold under the Roberti Bill, they would generate only a fraction of the property tax revenues that they would otherwise if the State sold them at fair market value. While Caltrans is determining whether it will proceed with the SR 710 extension project, the State could consider certain alternatives that would allow it to retain access to the right-of-way needed for the extension project. One option Caltrans could consider is contracting with one or more private contractors to provide property management services to maintain the SR 710 properties. Another option to consider is the establishment of a joint powers authority (JPA) that would include Caltrans and the cities of Pasadena, South Pasadena, and Los Angeles to manage the SR 710 properties.

In the report, the California State Auditor (state auditor) made the following recommendations to Caltrans and General Services. The state auditor's determination regarding the current status of recommendations is based on Caltrans' and General Services' responses to the state auditor as of October 2012.

#### **Recommendation 1.1.a—See pages 20—24 of the audit report for information on the related finding.**

To ensure that it collects fair market rents for the SR 710 properties on the State's behalf, Caltrans should, using the fair market rent determinations for all SR 710 properties it recently prepared and excluding those in its affordable rent program, adjust the tenants' rents to fair market after providing them with proper notice.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it is in the process of assessing rental rate increases to fair market rent and has sent letters to all SR 710 tenants requesting their financial information. Caltrans also stated that, once it completes its analysis of all of the information, it will work with the Business, Transportation and Housing Agency (agency) to determine the best course of action for it and the State. Caltrans anticipates that, after providing the affected tenants with the requisite 60-day notice, rental rate increases will be effective March 1, 2013.

**Recommendation 1.1.b—See pages 21—24 of the audit report for information on the related finding.**

To ensure that it collects fair market rents for the SR 710 properties on the State's behalf, Caltrans should make only limited exceptions to charging fair market rent and document the specific public purpose that is served in any case that it does not charge fair market rent.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it is in the process of assessing rental rate increases to fair market rent and has sent letters to all SR 710 tenants requesting their financial information. Caltrans also stated that, once it completes its analysis of all of the information, it will work with the agency to determine the best course of action for it and the State. Caltrans anticipates that, after providing the affected tenants with the requisite 60-day notice, rental rate increases will be effective March 1, 2013.

**Recommendation 1.2.a—See pages 24—27 of the audit report for information on the related finding.**

To ensure that all taxable fringe benefits or gifts state employees receive are appropriately included in their gross income, Caltrans should establish procedures to notify state employees who rent SR 710 properties that they may be subject to tax implications.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it has notified state employees who rent SR 710 properties that they may be subject to tax implications. However, Caltrans did not specifically address whether or not it established procedures.

**Recommendation 1.2.b—See page 25 of the audit report for information on the related finding.**

To ensure that all taxable fringe benefits or gifts employees receive are appropriately included in their gross income, Caltrans should continue to work with its information technology division to generate the reports necessary for it to provide the State Controller's Office (state controller) with the value of the state housing for its employees monthly.

***Caltrans' Action: No action taken.***

➔ Caltrans did not specifically address this recommendation.

**Recommendation 1.2.c—See pages 24—27 of the audit report for information on the related finding.**

To ensure that all taxable fringe benefits or gifts state employees receive are appropriately included in their gross income, Caltrans should work with the state controller to identify the statute of limitations for employers to report adjustments to employee gross income to the federal Internal Revenue Service and the California Franchise Tax Board.

*Caltrans' Action: Partially implemented.*

Caltrans stated that it obtained consent from the Attorney General's Office (attorney general) to retain independent legal counsel specializing in taxation to provide legal advice on the tax issues raised in this recommendation. Caltrans also stated that it sent a request for proposal on September 14, 2012, to several law firms listed on the State Bar of California's (state bar) Web site. According to Caltrans, upon receiving a legal opinion from the selected firm, it and the agency will evaluate the appropriate course of action for it and the State.

**Recommendation 1.2.d—See pages 24—27 of the audit report for information on the related finding.**

To ensure that all taxable fringe benefits or gifts state employees receive are appropriately included in their gross income, Caltrans should work with the state controller to identify the difference between the fair market rental value of the SR 710 housing and the rent state employees paid for that housing during the applicable calendar years related to the federal and state statute of limitations.

*Caltrans' Action: Partially implemented.*

Caltrans stated that it obtained consent from the attorney general to retain independent legal counsel specializing in taxation to provide legal advice on the tax issues raised in this recommendation. Caltrans also stated that it sent a request for proposal on September 14, 2012, to several law firms listed on the state bar's Web site. According to Caltrans, upon receiving a legal opinion from the selected firm, it and the agency will evaluate the appropriate course of action for it and the State.

**Recommendation 1.2.e—See pages 24—27 of the audit report for information on the related finding.**

To ensure that all taxable fringe benefits or gifts state employees receive are appropriately included in their gross income, Caltrans should work with the state controller to determine if it needs to revise the W-2 forms for the other employees to whom Caltrans provided housing benefits, including the four employees who worked at its Chilao Maintenance Station.

*Caltrans' Action: Partially implemented.*

Caltrans stated that it obtained consent from the attorney general to retain independent legal counsel specializing in taxation to provide legal advice on the tax issues raised in this recommendation. Caltrans also stated that it sent a request for proposal on September 14, 2012, to several law firms listed on the state bar's Web site. According to Caltrans, upon receiving a legal opinion from the selected firm, it and the agency will evaluate the appropriate course of action for it and the State.

**Recommendation 1.2.f—See pages 24—27 of the audit report for information on the related finding.**

To ensure that all taxable fringe benefits or gifts state employees receive are appropriately included in their gross income, Caltrans should provide information to the other state agencies so that they can submit the standard form for reporting the value of the housing provided to their employees for the applicable past calendar years to the state controller. Caltrans should continue to submit this information monthly to the applicable state agencies until the state employees are no longer renting the SR 710 properties at below-market rates.

*Caltrans' Action: Partially implemented.*

Caltrans stated that it obtained consent from the attorney general to retain independent legal counsel specializing in taxation to provide legal advice on the tax issues raised in this recommendation. Caltrans also stated that it sent a request for proposal on September 14, 2012, to several law firms listed on the state bar's Web site. According to Caltrans, upon receiving a legal opinion from the selected firm, it and the agency will evaluate the appropriate course of action for it and the State.



**Recommendation 1.3.a—See pages 27—29 of the audit report for information on the related finding.**

To ensure that the affordable rent policy is enforceable and that only eligible tenants receive the benefit of the policy, Caltrans should adopt regulations in accordance with the Administrative Procedure Act (APA) if the director determines that it is appropriate to continue to offer affordable rent to certain tenants.

***Caltrans' Action: Pending.***

Caltrans stated that the director is reviewing the affordable rent program to determine if it is appropriate to continue offering it to certain tenants and/or to expand it to include other tenants. Caltrans also stated that it is expected that the director will make a decision by November 2012.

**Recommendation 1.3.b—See pages 27—29 of the audit report for information on the related finding.**

To ensure that the affordable rent policy is enforceable and that only eligible tenants receive the benefit of the policy, Caltrans should annually review and document the tenants' household incomes using income certification forms. If tenants no longer qualify for the program because their income exceeds the income requirement or one of the income-producing tenants in the household has been replaced by a new tenant, it should increase their rent to fair market rates after giving proper notice.

***Caltrans' Action: Pending.***

Caltrans stated that the director is reviewing the affordable rent program to determine if it is appropriate to continue offering it to certain tenants and/or to expand it to include other tenants. Caltrans also stated that the director's decision is expected by November 2012.

**Recommendation 2.1.a—See page 32 of the audit report for information on the related finding.**

To ensure that the repairs it makes to the SR 710 properties are necessary and reasonable, Caltrans should document its rationale for approving project change orders.

***Caltrans' Action: Partially implemented.***

Caltrans' District 7 office management issued a memo on September 27, 2012, instructing staff to document their rationale for approving project change orders, effective immediately. Caltrans also stated that it is on track to complete the specific policy and procedures to ensure compliance and the related training by December 31, 2012.

**Recommendation 2.1.b—See pages 32 and 33 of the audit report for information on the related finding.**

To ensure that the repairs it makes to the SR 710 properties are necessary and reasonable, Caltrans should conduct annual field inspections of the properties.

***Caltrans' Action: Partially implemented.***

Caltrans' District 7 office management issued a memo on September 27, 2012, instructing staff to conduct annual field inspections of the properties, effective immediately. Caltrans stated that as of October 9, 2012, it had completed 371 of the 433 inspections and that it is on target to complete the remaining inspections by December 31, 2012.



**Recommendation 2.1.c—See page 33 of the audit report for information on the related finding.**

To ensure that the repairs it makes to the SR 710 properties are necessary and reasonable, Caltrans should discontinue performing roofing repairs on properties its roof assessments indicate are in good condition, unless a new assessment indicates a repair is needed.

***Caltrans' Action: Partially implemented.***

Caltrans' District 7 office management issued a memo on September 27, 2012, requiring all roof repair orders to have an updated assessment to determine if the repairs are necessary, effective immediately. Caltrans also stated that it is on track to complete the specific policy and procedures to ensure compliance by December 31, 2012.

**Recommendation 2.1.d—See pages 32 and 33 of the audit report for information on the related finding.**

To ensure that the repairs it makes to the SR 710 properties are necessary and reasonable, Caltrans should incorporate roof assessments as part of its annual field inspections of the properties.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it incorporated roof assessments as part of its annual inspections of properties. Caltrans also stated that it is on track to complete the specific policy and procedures to ensure compliance by December 31, 2012.

**Recommendation 2.1.e—See pages 34—36 of the audit report for information on the related finding.**

To ensure that the repairs it makes to the SR 710 properties are necessary and reasonable, Caltrans should develop a written policy to ensure that it considers the cost-effectiveness of repair costs for historic and nonhistoric projects in relation to the potential rental income for the property. Such a policy should establish the maximum acceptable cost-recovery period for the amount it will spend for repairs, above which the repairs will be considered wasteful.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it is developing a policy to assess the cost-effectiveness of repair costs, which will include evaluating a cost-recovery period for repairs. Caltrans also stated that it is on track to issue the policy and provide training to all employees by December 31, 2012.

**Recommendation 2.1.f—See pages 34—36 of the audit report for information on the related finding.**

To ensure that the repairs it makes to the SR 710 properties are necessary and reasonable, Caltrans should establish a process to ensure it evaluates the cost-effectiveness of any repair before authorizing it.

***Caltrans' Action: Partially implemented.***

Caltrans stated that its District 7 office management is developing a standardized process for evaluating the cost-effectiveness of repairs. Caltrans also stated that it anticipates implementing this process and providing training to the appropriate staff by December 31, 2012.

**Recommendation 2.1.g—See pages 32—36 of the audit report for information on the related finding.**

To ensure that the repairs it makes to the SR 710 properties are necessary and reasonable, Caltrans should retain in its project files evidence to support the necessity and reasonableness of repairs, such as change orders, annual field inspections, and analyses of cost-effectiveness.

***Caltrans' Action: Partially implemented.***

Caltrans' District 7 office management issued a memo on September 27, 2012, instructing staff to retain the required evidence to support the necessity and reasonableness of repairs in the project files, effective immediately. Caltrans also stated that it is on track to issue the specific policy and provide training to the appropriate staff by December 31, 2012.

**Recommendation 2.2—See pages 38 and 39 of the audit report for information on the related finding.**

To ensure that the State achieves cost savings for the repairs made to the SR 710 properties, Caltrans should periodically perform more comprehensive analyses of viable options for repairing the properties. If Caltrans determines that General Services is the best option, it should ensure that it properly executes an interagency agreement in accordance with the *State Contracting Manual*.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it is evaluating the best method to perform a cost comparison of options for the maintenance of the SR 710 properties. Caltrans anticipates completing the cost comparison by December 31, 2012. Caltrans also stated that, in the meantime, it initiated the execution of an interagency agreement with General Services.

**Recommendation 2.3—See pages 36—38 of the audit report for information on the related finding.**

To ensure that it appropriately executes interagency agreements with other state agencies, General Services should provide training to construction unit staff.

***General Services' Action: Pending.***

General Services stated that the construction unit will schedule its staff to attend the Services Contracting course offered by the California Procurement and Contracting Academy (Cal-PCA). General Services also stated that this course is taught by staff from its office of legal services and includes coverage of the State's requirements for the use of interagency agreements to contract with other state agencies.

**Recommendation 2.4.a—See pages 39—40 of the audit report for information on the related finding.**

To ensure that General Services performs only necessary repairs and that its costs are reasonable, Caltrans should ensure that its staff adhere to relevant contracting policies, including retaining evidence of its approval of General Services' repair work before and after the completion of a project in the project file.

***Caltrans' Action: Partially implemented.***

Caltrans' District 7 office management issued a memo on September 27, 2012, instructing staff to retain the required evidence to support the necessity and reasonableness of repairs in the project files, effective immediately. Caltrans stated the required evidence would include approval of General Services' work before and after project completion. Caltrans also stated that it is on track to issue the specific policy and provide training to the appropriate staff by December 31, 2012.

**Recommendation 2.4.b—See pages 40 and 41 of the audit report for information on the related finding.**

To ensure that General Services performs only necessary repairs and that its costs are reasonable, Caltrans should reconcile General Services' estimates for the repair projects with the scope of work the Department of Finance (Finance) approved in the transfer request form, and, if applicable, explain any differences.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it is meeting with General Services to develop a process to reconcile the estimates for repairs with the scope of work in the transfer request forms. Caltrans expects this process to be in place by December 31, 2012.

**Recommendation 2.4.c—See pages 40 and 41 of the audit report for information on the related finding.**

To ensure that General Services performs only necessary repairs and that its costs are reasonable, Caltrans should reconcile the actual work General Services performs to the scope of work approved in the project work plans.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it is meeting with General Services to develop a process to reconcile the actual work performed to the scope of work approved in the project work plans. Caltrans expects this process to be in place by December 31, 2012.

**Recommendation 2.4.d—See pages 40 and 41 of the audit report for information on the related finding.**

To ensure that General Services performs only necessary repairs and that its costs are reasonable, Caltrans should reconcile the actual expenditures for the projects listed in the transfer request form approved by Finance and the approved budget in the project work plans with General Services' actual expenditures for each project.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it is using its March 2012 tracking spreadsheet to reconcile actual expenditures to the approved budget for the work being done by General Services. However, the effectiveness of this spreadsheet is contingent upon Caltrans' implementation of recommendation 2.4.e. Further, Caltrans did not specifically address whether or not it reconciles the actual expenditures for the projects listed in the transfer request form approved by Finance.

**Recommendation 2.4.e—See pages 40 and 41 of the audit report for information on the related finding.**

To ensure that General Services performs only necessary repairs and that its costs are reasonable, Caltrans should modify its March 2012 tracking spreadsheet to ensure that it contains sufficient information for Caltrans to effectively monitor repair costs.

***Caltrans' Action: Partially implemented.***

Caltrans stated that it is working with General Services to obtain the necessary data to monitor repair costs. Caltrans anticipates it will complete the final modifications to its March 2012 tracking spreadsheet on or before December 31, 2012.

**Recommendation 3.1.a—See pages 43—45 of the audit report for information on the related finding.**

To ensure that it charges its clients appropriately for the work it performs, General Services should reassess the construction unit's methodologies for determining the hourly burden rate and direct administration fees.

***General Services' Action: Partially implemented.***

General Services stated that its construction unit will revise its rate-setting process for fiscal year 2013–14 to fully address the state auditor's concerns. General Services also stated that the revised process will ensure that the construction unit's hourly burden rate and direct administration fees are accurately and properly calculated based on prior year expenditure data and projected billable hours. Further, General Services stated that, to date, the construction unit has consulted with General Services' budget, accounting, and information technology staff on improvements that can be made to its rate and fees calculation function.

**Recommendation 3.1.b—See pages 43—45 of the audit report for information on the related finding.**

To ensure that it charges its clients appropriately for the work it performs, General Services should ensure that the construction unit's methodologies are sound and that it can properly support them.

***General Services' Action: Partially implemented.***

General Services stated that its construction unit will revise its rate-setting process for fiscal year 2013–14 to fully address the state auditor's concerns. General Services also stated that the revised process will ensure that the construction unit's hourly burden rate and direct administration fees are accurately and properly calculated based on prior year expenditure data and projected billable hours. Further, General Services stated that, to date, the construction unit has consulted with General Services' budget, accounting, and information technology staff on improvements that can be made to its rate and fees calculation function.

**Recommendation 3.2—See pages 46—48 of the audit report for information on the related finding.**

To determine if the construction unit's use of casual laborers to perform work not in their job specifications, such as procurement, is cost-effective, General Services should perform an analysis comparing the cost of paying the casual laborers at the prevailing wage rate and the cost of paying permanent civil service employees. If it finds that using permanent employees is cost-effective for the State, General Services should seek approval for additional permanent employees to perform those functions.

***General Services' Action: Partially implemented.***

General Services stated that its construction unit is in the final stages of analyzing the cost effectiveness of its practice of using a limited number of casual laborers to occasionally perform office administrative type tasks, such as procurement.

**Recommendation 3.3.a—See pages 46—50 of the audit report for information on the related finding.**

To ensure that the casual laborers charge only for their actual hours worked on projects, General Services should require that the civil service supervisor who has knowledge of the time the casual laborer works approve the casual laborer's daily time report and the Activity Based Management System time charges.

*General Services' Action: No action taken.*

General Services did not specifically address this recommendation.



**Recommendation 3.3.b—See pages 46—50 of the audit report for information on the related finding.**

To ensure that the casual laborers charge only for their actual hours worked on projects, General Services should ensure that the daily time reports for casual laborers contain the appropriate task codes, the laborer's signature, and the approval of a civil service supervisor.

*General Services' Action: No action taken.*

General Services did not specifically address this recommendation.



**Recommendation 3.3.c—See pages 48—50 of the audit report for information on the related finding.**

To ensure that the casual laborers charge only for their actual hours worked on projects, General Services should update its construction unit manual to formalize its standard practice of using daily job reports for each project.

*General Services' Action: No action taken.*

General Services did not specifically address this recommendation.



**Recommendation 3.3.d—See pages 48—50 of the audit report for information on the related finding.**

To ensure that the casual laborers charge only for their actual hours worked on projects, General Services should retain the daily job reports and the daily time reports in the project files.

*General Services' Action: No action taken.*

General Services did not specifically address this recommendation.



**Recommendation 3.4—See page 50 of the audit report for information on the related finding.**

To ensure that it complies with its nepotism policy, General Services should have its office of human resources review and approve its existing temporary authorization appointments for casual laborers. If the office of human resources finds that personal relationships exist, General Services should take appropriate action in accordance with its policy.

*General Services' Action: Partially implemented.*

General Services stated that its office of audit services is conducting a review of the construction unit's operations to determine compliance with the nepotism policy. General Services also stated that it is updating its nepotism policy, as well as the nepotism process contained in its Personnel Operations Manual, to provide additional guidance to staff. General Services plans to issue its updated nepotism policy by October 31, 2012. Further, General Services stated that, upon issuance of the new policy, its office of human resources will work with the construction unit to ensure that the construction unit's staff are fully trained on its nepotism policy and practices.

**Recommendation 3.5.a—See page 55 of the audit report for information on the related finding.**

To ensure that the construction unit complies with the State's procurement laws and policies, General Services should require the construction unit to immediately discontinue its current procurement practices that are inconsistent with the State's procurement laws and policies.

***General Services' Action: Partially implemented.***

General Services stated that the construction unit has taken actions to discontinue any procurement practices that do not comply with state requirements, including the implementation of additional policies and procedures that ensure the rotating of suppliers and obtaining a minimum of two quotes for all purchases. Further, General Services stated that the construction unit headquarters staff are actively monitoring compliance with the new operating requirements.

**Recommendation 3.5.b—See page 55 of the audit report for information on the related finding.**

To ensure that the construction unit complies with the State's procurement laws and policies, General Services should require the construction unit to modify the procurement section of its manual to conform to the State's procurement laws and policies.

***General Services' Action: Partially implemented.***

General Services stated that the construction unit is updating the procurement section of its policy manual to conform to the State's procurement requirements and plans to issue its updated policies by November 30, 2012.

**Recommendation 3.5.c—See pages 50—55 of the audit report for information on the related finding.**

To ensure that the construction unit complies with the State's procurement laws and policies, General Services should provide training to its construction unit employees regarding the State's procurement laws and policies.

***General Services' Action: Partially implemented.***

General Services stated that, based on course availability, the construction unit is actively enrolling its purchasing staff in Cal-PCA courses that provide acquisition specialists with the knowledge essential to conduct purchases in accordance with state requirements.

**Recommendation 3.5.d—See page 56 of the audit report for information on the related finding.**

To ensure that the construction unit complies with the State's procurement laws and policies, General Services should clarify the waiver process in the administrative order governing the small business participation goal.

***General Services' Action: Partially implemented.***

General Services stated that it will amend its administrative order to include additional examples of situations in which waivers may be granted. General Services plans to issue its amended administrative order by November 30, 2012.

**Recommendation 3.5.e—See page 56 of the audit report for information on the related finding.**

To ensure that the construction unit complies with the State's procurement laws and policies, General Services should continue its efforts to implement regulations that govern the small business certification process related to defining and enforcing violations of commercially useful function requirements.

***General Services' Action: Partially implemented.***

General Services expects the Office of Administrative Law (OAL) will approve the final regulations by January 31, 2013.

**Recommendation 3.5.f—See pages 50—57 of the audit report for information on the related finding.**

To ensure that the construction unit complies with the State's procurement laws and policies, General Services should conduct an investigation of the small businesses we discussed in the report to determine if they are performing a commercially useful function.

***General Services' Action: Partially implemented.***

General Services stated that its office of audit services, in consultation with its construction unit and office of small business and disabled veterans business enterprise services, is investigating the small businesses discussed in the report to determine if they are performing a commercially useful function.

**Recommendation 4.1—See pages 59—64 of the audit report for information on the related finding.**

To ensure the State properly manages its resources, the Legislature should consider amending the state law known as the Roberti Bill to allow Caltrans to sell SR 710 properties that have high market value at fair market prices.

***Legislative Action: Legislation vetoed.***

The governor vetoed Senate Bill 204 of the 2011–12 Regular Legislative Session on September 30, 2012. This bill would have required the California Transportation Commission and Caltrans to declare as excess certain state properties acquired for the SR 710 surface freeway extension and required Caltrans to expeditiously release those properties for sale, with the tenants of those properties being offered the first right of refusal to purchase the properties at fair market value.

**Recommendation 4.2—See page 60 of the audit report for information on the related finding.**

To comply with the 2007 court ruling and the APA until such time as the Legislature may choose to act, Caltrans should establish regulations to govern the sales process for the SR 710 properties affected by the Roberti Bill.

***Caltrans' Action: Partially implemented.***

Caltrans stated it anticipates submitting its proposed regulations to OAL for approval by the end of 2012.

**Recommendation 4.3.a—See page 65 of the audit report for information on the related finding.**

To pursue alternatives to its management of the SR 710 properties, Caltrans should prepare a cost-benefit analysis to determine if the State would save money by hiring a private vendor to manage the properties. If such savings would occur, Caltrans should seek an exemption under Government Code, Section 19130 (a), to hire a private vendor.



***Caltrans' Action: Partially implemented.***

Caltrans stated it hired a consultant to perform an independent cost-benefit analysis of the following property management options for the SR 710 properties: hiring a private vendor, establishing a JPA, and transferring the properties to a local transportation entity. The local transportation entity would take over ownership and management of the properties and use the proceeds of the sale for local transportation improvements. Caltrans also stated that its first meeting with the consultant would be held in October 2012 to develop a work plan with target dates.

**Recommendation 4.3.b—See page 66 of the audit report for information on the related finding.**

To pursue alternatives to its management of the SR 710 properties, Caltrans should perform an analysis to compare the cost of establishing a JPA to its current costs of managing the properties.

***Caltrans' Action: Partially implemented.***

Caltrans stated it hired a consultant to perform an independent cost-benefit analysis of the following property management options for the SR 710 properties: hiring a private vendor, establishing a JPA, and transferring the properties to a local transportation entity. The local transportation entity would take over ownership and management of the properties and use the proceeds of the sale for local transportation improvements. Caltrans also stated that its first meeting with the consultant would be held in October 2012 to develop a work plan with target dates.

**Recommendation 4.4—See pages 64—66 of the audit report for information on the related finding.**

To pursue alternatives to the State's management of the SR 710 properties that would preserve its access to the right-of-way needed for the extension project, to the extent that Caltrans has determined it to be cost-beneficial to do so, the Legislature should consider the establishment of a JPA that would allow Caltrans and the affected cities to jointly manage the SR 710 properties.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.



## High-Speed Rail Authority Follow-Up

### Although the Authority Addressed Some of Our Prior Concerns, Its Funding Situation Has Become Increasingly Risky and the Authority's Weak Oversight Persists

#### REPORT NUMBER 2011-504, ISSUED JANUARY 2012

In January 2012 we issued a report that presents the results of a follow-up review the California State Auditor (state auditor) conducted concerning the efforts by the High-Speed Rail Authority (Authority) to implement recommendations from an earlier audit report that we issued in April 2010. The state auditor's report titled *High-Speed Rail Authority: It Risks Delays or an Incomplete System Because of Inadequate Planning, Weak Oversight, and Lax Contract Management*, Report 2009-106, examined the Authority's readiness to manage funds authorized for building the high-speed rail network (program) in California, including the \$9 billion in general obligation bonds the voters authorized in November 2008. As a result of our follow-up audit, we concluded that the Authority has fully implemented four recommendations, partially implemented five, and taken no action on the remaining one.

Although the Authority has implemented some of the recommendations we made in our prior report, significant problems persist. For example, the program's overall financial situation has become increasingly risky. This is in part because the Authority has not provided viable funding alternatives in the event that its planned funding does not materialize. In its 2012 draft business plan, the Authority more than doubled its previous cost estimates for phase one of the program, to between \$98.1 billion and \$117.6 billion. Of this amount, the Authority has secured only approximately \$12.5 billion as of January 2012. Further, the Authority's 2012 draft business plan still lacks key details about the program's costs and revenues.

In addition to our concerns related to the Authority's 2012 draft business plan, we also identified a number of critical, ongoing problems involving its oversight of the program. Specifically, in part because the Authority is significantly understaffed, it has delegated significant control to its contractors—especially the entity that manages the program (Program Manager). The Authority relies on the Program Manager to provide accurate, consistent, and useful information in its monthly progress reports. However, we found that these reports were often inaccurate and that at times the Program Manager appeared to misinform the Authority about the speed with which contractors for each region performed their assigned tasks. Finally, even though the majority of the Authority's role in administering the program involves its management of contracts, we discovered during the course of our work that the Authority had engaged in inappropriate contracting practices involving information technology services. The nature of these problems suggests that the Authority needs to significantly improve its internal controls to ensure that it effectively manages its contracts.

In the follow-up report, the state auditor made the following recommendations to the Authority, one to the Legislature, and one to the Department of General Services (General Services). The state auditor's determination regarding the current status of recommendations is based on the Authority's and General Services' response to the state auditor as of August 2012.

#### **Recommendation 1.1.a—See page 54 of the follow-up audit report for information on the related finding.**

To ensure that it can respond adequately to funding levels that may vary from its business plan, the Authority should develop and publish alternative funding scenarios that reflect the possibility of reduced or delayed funding from the planned sources. These scenarios should detail the implications of variations in the level or timing of funding on the program and its schedule.

#### ***Authority's Action: Partially implemented.***

The Authority stated that it continues to work with stakeholders to define alternative delivery scenarios on blended system operations. Additionally, the Authority asserted that in the spring of 2012, the Department of Finance and the Administration identified cap-and-trade revenues as a

potential funding source for the program. Further, the Authority stated that it will work with the Department of Finance to define a specific plan for the use of cap-and-trade funds, which it claims will be presented in detail in the next business plan to be issued in draft in the fall of 2013. However, although the Authority's business plan includes three alternative funding scenarios, all three assume a similar or increased level of federal funding compared to the Authority's primary plan—which the federal government has not indicated will occur.

**Recommendation 1.1.b—See page 54 of the follow-up audit report for information on the related finding.**

In order to respond effectively to circumstances that could significantly delay or halt the program, the Authority should ensure that it implements planned actions related to managing risk.

***Authority's Action: Fully implemented.***

The Authority hired a risk manager in August 2012. The Authority asserts that the risk manager will attend the risk management meetings related to updating the risk register, identifying new risks, performing qualitative risk analyses, and coordinating and tracking risk responses.

**Recommendation 1.1.c—See page 54 of the follow-up audit report for information on the related finding.**

To avert possible legal challenges, the Authority should ensure that the independent peer review panel adheres to the Bagley-Keene Open Meeting Act or seek a formal opinion from the Office of the Attorney General (attorney general) regarding whether the panel is subject to this act.

***Authority's Action: No action taken.***

- ➔ The Authority originally addressed our recommendation by requesting an opinion from the attorney general on January 5, 2012. Subsequently, on October 16, 2012, it withdrew its request for a legal opinion stating that it did so because the independent peer review group is appointed by the State Treasurer, the State Controller, the Director of Finance, and the Secretary of Business, Transportation and Housing. The Authority explained that although it provides information requested by the peer review group, it believes that it does not have the legal authority to direct how the peer review group conducts its meetings including providing legal advice to the group about open meeting law requirements. Nevertheless, while the Authority does not appoint the members of the peer review group, state law requires the Authority to “establish” the independent peer review group and, as such, we believe the Authority would be an appropriate entity to request the opinion. In addition, the peer review group informed us that it believes its actions are not covered by the Bagley-Keene Open Meeting Act when it conducts its meetings. The peer group bases its belief on the advice of the authority's former counsel when it explained to us why it does not comply with the Bagley-Keene Open Meeting Act. Therefore, the Authority has not implemented our recommendation.

**Recommendation 1.1.d—See page 54 of the follow-up audit report for information on the related finding.**

To ensure that it does not run out of funds for administrative and preconstruction tasks prematurely, the Authority should track expenditures for these activities and develop a long-term spending plan for them. It also should develop procedures and systems to ensure that it complies with American Recovery and Reinvestment Act of 2009 requirements.

***Authority's Action: Fully implemented.***

The Authority implemented monthly control procedures and a supporting spreadsheet that utilizes cost data from CalStars to report cumulative information for administrative and preconstruction costs. The spreadsheet provides a breakdown of administrative and preconstruction expenditures by fiscal year and the percentage these expenditures represent of the total allowable expenditures authorized in Proposition 1A. The Authority stated that the

spreadsheet will be combined with Program Manager information to project administrative and preconstruction expenditures. The Authority also asserts the spreadsheet may be used for future cost projections.

**Recommendation 1.1.e—See page 55 of the follow-up audit report for information on the related finding.**

In order to ensure that staff receive relevant information on the program's status, the Authority should amend the oversight consultant's work plan to include a critical review of the progress reports for accuracy and consistency. Authority staff should also request that the Program Manager revise its progress reports to include information on the status of contract products and services in relationship to what was promised.

***Authority's Action: Fully implemented.***

The Authority amended the oversight consultant's work plan to include a critical review of the progress reports. In addition, the Authority provided four recent copies of the Program Manager's progress reports that included information on the status of contract products and services in relationship to what was promised.

**Recommendation 1.1.f—See page 55 of the follow-up audit report for information on the related finding.**

To ensure that it does not misuse public funds and can hold contractors accountable, the Authority should adhere to the conditions of its contracts and work plans, and make any amendments and modifications in writing.

***Authority's Action: Fully implemented.***

As published in our March 2011 report titled *Implementation of State Auditor's Recommendations, Audits Released in January 2009 Through December 2010* (Report 2011-406), the Authority amended its contract with the Program Manager to require the use of an audit-adjusted field rate—a discounted overhead rate used when consultants use client facilities. Further, the Authority amended its contract with a regional contractor to include work that was not part of the original contract. Finally, the Authority implemented a change control process, which includes making any amendments and modifications to contracts and work plans in writing.

**Recommendation 1.2—See page 15 of the follow-up audit report for information on the related finding.**

To add clarification to the first recommendation we made in our prior report that stated, "To ensure that it can respond adequately to funding levels that may vary from its business plan, the Authority should develop and publish alternative funding scenarios that reflect the possibility of reduced or delayed funding from the planned sources. These scenarios should detail the implications of variations in the level or timing of funding on the program and its schedule," the Authority should also present viable alternative funding scenarios for phase one in its entirety that do not assume an increase in the federal funding levels already identified in the 2012 draft business plan. If the Authority does not believe that such alternatives exist, it should publicly disclose this in its 2012 final business plan.

***Authority's Action: Partially implemented.***

The Authority stated that it continues to work with stakeholders to define alternative delivery scenarios on blended system operations. Additionally, the Authority asserted that in the spring of 2012, the Department of Finance and the Administration identified cap-and-trade revenues as a potential funding source for the program. Further, the Authority stated that it will work with the Department of Finance to define a specific plan for the use of cap-and-trade funds, which it claims will be presented in detail in the next business plan to be issued in draft in the fall of 2013. However, although the Authority's business plan includes three alternative funding scenarios, all three assume a similar or increased level of federal funding compared to the Authority's primary plan—which the federal government has not indicated will occur.

**Recommendation 1.3.a—See page 21 of the follow-up audit report for information on the related finding.**

To ensure that the public and the Legislature are aware of the full cost of the program, the Authority should clearly report total costs, including projected operating and maintenance costs for the program.

***Authority's Action: Fully implemented.***

The Authority's 2012 revised business plan discusses total capital costs including operating and maintenance costs. The Authority believes that capital costs and operating and maintenance costs, including costs by year, have been accurately and thoroughly discussed in an open manner through a range of communication media, including through board meetings that are open to the public.

**Recommendation 1.3.b—See page 21 of the follow-up audit report for information on the related finding.**

To ensure that the public and the Legislature are aware of the full cost of the program, the Authority should clearly disclose that the 2012 draft business plan assumes that the State will only be receiving profits for the first two years of operation in 2022 and 2023, and potentially not again until 2060 in exchange for the almost \$11 billion the Authority assumes it will receive from the private sector over a four-year period.

***Authority's Action: Pending.***

The Authority stated that it would clarify in its next business plan the decision by the State to raise financing from the private sector based on the net cash flows of the project, which means the State will not be able to use those cash flows for other purposes during the term of the financing.

**Recommendation 1.4—See page 23 of the follow-up audit report for information on the related finding.**

To assure independence and instill public confidence in the process regarding the Authority's ridership model, the Legislature should draft legislation that establishes an independent ridership review group. For example, the Legislature could use a similar process to the one used to establish the independent peer review panel that the law requires to assess the Authority's business plans.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 2.1.a—See page 28 of the follow-up audit report for information on the related finding.**

To ensure that it has adequate staff to effectively oversee the program, the Authority should continue to fill its vacant positions.

***Authority's Action: Partially implemented.***

As of October 2012 the Authority filled all but one of its high-level vacant positions; the position of chief financial officer remains vacant.

**Recommendation 2.1.b—See page 31 of the follow-up audit report for information on the related finding.**

To ensure that it has adequate staff to effectively oversee the program, the Authority should conduct a workload analysis to determine the total number of staff it needs as well as the functions those staff should perform.

***Authority's Action: Pending.***

The Authority stated that it will explore available options for conducting a workload analysis once it has filled its high-level positions.

**Recommendation 2.2—See page 31 of the follow-up audit report for information on the related finding.**

To comply with the political reform act, the Authority should establish written policies and procedures for tracking whether all designated employees and consultants have completed and filed their statements of economic interests on time, thereby identifying any potential conflicts of interest.

***Authority's Action: Fully implemented.***

The Authority has written policies and procedures in place to collect, follow up, and retain statements of economic interest. Those policies and procedures include sections on annual statements, assuming office statements, leaving office statements, and retention. The procedures were approved by the chief executive officer on July 17, 2012.

**Recommendation 2.3—See page 31 of the follow-up audit report for information on the related finding.**

To increase transparency and to ensure that it is aware of any financial interest that a subcontractor may have in the program, the Authority should require subcontractors to file statements of economic interest.

***Authority's Action: Partially implemented.***

The Authority asserts that it has put a process in place for determining which contractors and subcontractors should file statements of economic interest. However, not all subcontractors will be required to file. In addition, the Authority's policies state that prime contractors, not Authority staff, are responsible for determining which subcontractors are subject to the conflict-of-interest policy.

**Recommendation 2.4.a—See page 35 of the follow-up audit report for information on the related finding.**

To ensure that the Program Manager's monthly progress reports are accurate, consistent, and useful, the Authority should reinstate the oversight consultant's review of the progress reports.

***Authority's Action: Fully implemented.***

The Authority asserted that the oversight consultant reviews the Program Manager's monthly progress reports and makes observations and recommendations to the Program Manager.

**Recommendation 2.4.b—See page 35 of the follow-up audit report for information on the related finding.**

To ensure that the Program Manager's monthly progress reports are accurate, consistent, and useful, the Authority should hold the Program Manager accountable for implementing the oversight consultant's recommendations. For example, the Authority could withhold partial payment of invoices to the Program Manager until it fully addresses these recommendations.

***Authority's Action: Fully implemented.***

The Authority stated that the Program Manager discusses, reviews, and incorporates the observations and recommendations of the oversight consultant into a written response to the Authority. The Authority also asserted that its contract managers have the ability to withhold payments in order to deal with nonperformance issues. Additionally, the Authority stated that it continues to add resources to its team to augment its oversight responsibility.



**Recommendation 2.4.c—See page 34 of the follow-up audit report for information on the related finding.**

To ensure that the Program Manager's monthly progress reports are accurate, consistent, and useful, the Authority should conduct monthly comparisons of the Program Manager's and the regional contractors' progress reports to verify that they are consistent with one another and to ensure that the reports include an accurate status of promised deliverables.

***Authority's Action: Fully implemented.***

The Authority stated that the oversight consultant, acting as an extension of the Authority, reviews the Program Manager's monthly progress reports and makes observations and recommendations. Those observations and recommendations are reviewed by the program director and are discussed, reviewed, and incorporated into a written response to the Authority. In addition, the Authority indicated that its audit office's work plan includes scheduled audits of the regional contractors' progress reports and invoices, as well as comparisons on a sample of the Program Manager's and the regional contractors' progress reports. It also stated that the audit office will review the Program Manager's and oversight consultant's activities.

**Recommendation 2.5—See page 37 of the follow-up audit report for information on the related finding.**

To ensure that the regional contractors' monthly progress reports provide sufficient detail to support the monthly invoices, the Authority should perform a monthly comparison of the regional contractors' invoices with the corresponding progress reports. Specifically, the Authority should ensure that the regional contractors' monthly progress reports describe the work they performed in those areas for which they claimed costs in the corresponding invoices. The Authority should discuss with the Program Manager any areas that lack sufficient detail in the progress reports to make such determinations.

***Authority's Action: Fully implemented.***

According to the Authority, to ensure that sufficient detail is provided in the regional contractors' monthly progress reports and that the program director adequately documents any reporting deficiencies noted in the review of the progress reports and invoices, the audit office's work plan includes scheduled audits of the regional contractors' monthly progress reports and invoices and the Program Manager's and oversight consultant's activities. The audit office reports directly to the Audit and Finance Committee of the Authority's board and administratively to the chief executive officer.

**Recommendation 2.6.a—See page 38 of the follow-up audit report for information on the related finding.**

To be aware of and respond effectively to circumstances that could significantly delay or halt the program, the Authority should hire a risk manager as soon as possible. Until then, it should designate and require Authority staff to attend risk-management meetings and workshops.

***Authority's Action: Fully implemented.***

The Authority hired a risk manager in August 2012. According to the Authority, the risk manager will attend the risk management meetings related to updating the risk register, identifying new risks, performing qualitative risk analyses, and coordinating and tracking risk responses.

**Recommendation 2.6.b—See page 38 of the follow-up audit report for information on the related finding.**

To be aware of and respond effectively to circumstances that could significantly delay or halt the program, the Authority needs to be involved in the development and implementation of the Program Manager's risk-management plan and ensure that Authority staff have roles and responsibilities defined in the plan, such as identifying and mitigating risks in the risk register.

***Authority's Action: Fully implemented.***

The Authority stated that the new risk management program includes four general types of risk management workshops and meetings that involve Authority staff. The first type of risk management meeting serves to regularly update the risk register, identify new risks, perform qualitative risk analysis, and coordinate and track risk responses—this includes a review of all program and project risks. In addition, the Authority stated that its risk manager is assessing the current risk meeting process and will be making recommendations for enhancements that will be implemented under the Authority's updated risk management plan.

**Recommendation 2.6.c—See page 38 of the follow-up audit report for information on the related finding.**

To be aware of and respond effectively to circumstances that could significantly delay or halt the program, the Authority should monitor the Program Manager's risk management practices to ensure that either it or the Program Manager identifies and promptly and appropriately addresses risks.

***Authority's Action: Fully implemented.***

The Authority indicated that its risk manager plans to regularly meet with risk management staff, including the Program Manager, to provide necessary Authority control, direction, oversight, and information sharing.

**Recommendation 2.7.a—See page 40 of the follow-up audit report for information on the related finding.**

To effectively manage its contracts, the Authority should develop procedures to detect and prevent contract splitting.

***Authority's Action: Fully implemented.***

According to the Authority, all staff with responsibility for preparing contracts have completed the General Services' training on proper state contracting procedures, including the prohibition against contract splitting. The Authority's contract manual has been updated and provided to Authority employees who have responsibility for preparing contracts. To detect contract splitting, all non-state agency contracts are reviewed prior to execution by the contract specialist within the Authority's contracts and procurement department.

**Recommendation 2.7.b—See page 40 of the follow-up audit report for information on the related finding.**

To effectively manage its contracts, the Authority should begin awarding contracts with a sufficient amount of lead time.

***Authority's Action: Fully implemented.***

The Authority provided a schedule of contract expiration dates to ensure that contract managers receive timely notifications from the contract unit of contract expiration dates. Additionally, the Authority asserted that its contract manual contains language ensuring adequate lead time in the contract award process.

**Recommendation 2.7.c—See page 40 of the follow-up audit report for information on the related finding.**

To effectively manage its contracts, the Authority should immediately begin the process of soliciting competitive bids for its IT services.

***Authority's Action: Partially implemented.***

The Authority asserted that it is moving toward in-house IT support rather than contractors. Specifically, the Authority stated that it hired a DPM II on March 5, 2012. According to the Authority's response, the new DPM II has moved the Authority's network connection from the cloud to the California Technology Agency (CTA) and has implemented the movement of the exchange services from its previous contractor—PK Inc.—to CTA-California Email Service (CES) mail. The Authority claims the process of migrating the electronic mail system to CES will be approximately six to 13 months. Additionally, the Authority stated that desktop support has been transitioned in-house with the support of one full-time associate information systems analyst and a student intern. The Authority further indicated that two retired annuitants have been hired to support the server and network administration, and application development.

**Recommendation 2.8—See page 40 of the follow-up audit report for information on the related finding.**

To ensure that the Authority is complying with state contracting rules and is following the guidelines of the *State Contracting Manual*, General Services should conduct a procurement audit of the Authority by January 1, 2013.

***General Services' Action: Fully implemented.***

Effective May 1, 2012, General Services indicated that the Authority lacks sufficiently trained staff to conduct procurements and subsequently decreased the Authority's purchasing authority to the minimum level of \$4,999.99. Thus, General Services now conducts all of the Authority's purchases above \$4,999.99. As a result of decreasing the Authority's purchasing authority, it is not necessary for General Services to conduct a procurement audit.



## Department of General Services

### Misuse of State Resources (Case I2008-1024)

#### REPORT NUMBER I2010-2, CHAPTER 5, ISSUED JANUARY 2011

This report concludes that a manager with the Department of General Services (General Services) improperly used state vehicles for his daily commute for nine years. The cost of the misuse from July 2006 through July 2009, the three years for which complete records are available, totaled an estimated \$12,379. Because the records were not retained, we were not able to accurately estimate the cost to the State for the remaining six years.

In the report, the California State Auditor (state auditor) made the below recommendations to General Services. The state auditor's determination regarding the current status of recommendations is based on General Services' response to the state auditor as of June 2011.

#### **Recommendation 1—See pages 29—31 of the investigative report for information on the related finding.**

General Services should seek reimbursement from the manager for the costs associated with his misuse of state vehicles.

#### ***General Services' Action: Fully implemented.***

In June 2011 General Services and the manager signed an agreement directing the manager to reimburse the State \$12,379 in costs arising from his misuse of state vehicles. The terms of the agreement require the manager to repay the State \$200 a month from June 2011 through August 2016. Through April 2012, the manager had made 11 monthly installment payments, leaving a remaining balance of \$10,179.

#### **Recommendation 2—See pages 15—17 of the investigative report for information on the related finding.**

General Services should issue a memorandum regarding the appropriate use of state-owned vehicles to all fleet division employees with access to state vehicles.

#### ***General Services' Action: Fully implemented.***

General Services stated that in March 2010, before the completion of our investigation, it issued a number of operating policies to its employees that prohibit the use of state-owned vehicles for travel to and from an employee's home without express permission.



# Department of Industrial Relations

## Failure to Monitor Adequately Employees' Time Reporting (Case I2008-0902)

### REPORT NUMBER I2011-1, CHAPTER 6, ISSUED AUGUST 2011

This report found that an official and a supervisor at a district office of the Department of Industrial Relations (Industrial Relations) failed to monitor adequately the time reporting of four subordinate employees from July 2007 through June 2009.

In the report, the California State Auditor (state auditor) made the following recommendation to Industrial Relations. The state auditor's determination regarding the current status of the recommendation is based on Industrial Relations' response to the state auditor as of September 2011.

**Recommendation—See pages 39 and 40 of the investigative report for information on the related finding.**

To ensure that employees at this district office follow time-reporting requirements in accordance with applicable state law and department policies, Industrial Relations should continue to monitor the time-reporting practices of the official and his staff.

***Industrial Relations' Action: Fully implemented.***

Industrial Relations reported that it provided further time-reporting and record-keeping training to all of its managers and supervisors. In addition, Industrial Relations issued a memorandum about attendance and reporting requirements to all of its district offices. Finally, Industrial Relations stated that it had provided training to all attendance reporting officers about the proper documentation of all hours worked and leave taken.



# Employment Development Department

## Conspiracy to Commit Mail Fraud (Case I2008-1217)

### REPORT NUMBER I2012-1, CHAPTER 2, ISSUED DECEMBER 2012

This report concludes that a former Employment Development Department (EDD) accounting technician and two accomplices committed and were convicted of conspiracy to commit mail fraud for executing a scheme to redirect unemployment insurance (unemployment) benefits from the State to ineligible recipients. Through falsifying a bankrupt company's wage information regarding laid-off employees, the accounting technician enabled her two coconspirators to file unemployment claims for benefits to which they were not entitled. During the duration of the scheme, from August 2008 through October 2010, the two accomplices used the U.S. mail to receive \$92,826 in unemployment claims on wages they did not earn. The accounting technician and one of her accomplices were sentenced to serve time in federal prison. The second accomplice was sentenced to three years of probation.

In the report, the California State Auditor (state auditor) made the following recommendation to EDD. The state auditor's determination regarding the current status of the recommendation is based on EDD's response to the state auditor as of October 2012.

#### **Recommendation 1—See pages 13—15 of the investigative report for information on the related finding.**

To minimize the potential for unauthorized changes to employers' wage information, EDD should strengthen its controls surrounding employees' access and authorization to change data for companies reporting employment information used in EDD's unemployment system.

#### ***EDD's Action: Fully implemented.***

EDD reported that it created a new daily transaction report to alert managers when changes are made to employment records. Most importantly, this report identifies changes made to names, social security numbers, or wage records on the unemployment system by EDD employees when no business need for such changes appears to exist. Finally, this new report provides managers with a tool to monitor transactions performed by accounting technicians.



# Franchise Tax Board and Office of the Secretary of State Bribery (Case I2009-0634)

## REPORT NUMBER I2012-1, CHAPTER 1, ISSUED DECEMBER 2012

This report concludes that a Franchise Tax Board (board) employee, an Office of the Secretary of State (secretary of state) employee, and a courier service owner engaged in an elaborate scheme that enabled the courier service owner to steal nearly a quarter of a million dollars from the State. The three individuals were convicted of bribery and ordered to pay a total of \$227,430 in restitution to the board and the secretary of state. The failure of the board and the secretary of state to maintain adequate controls contributed to these individuals' ability to perpetrate fraud. Consequently, as of October 2012 both entities determined that their existing internal control environments had weaknesses contributing to the fraud and reacted appropriately to strengthen their processes.

Both state agencies strengthened their internal controls in response to the bribery scheme. The board implemented an automated process that eliminated the need for businesses to pay for the services that had led to the bribery and it established a reconciliation process to ensure the proper accounting for transactions related to the services. The secretary of state strengthened its controls for cash receipts and related transactions. Furthermore, it ordered two of its regional offices to cease providing the services that had led to the bribery. As of October 2012 we determined that the board and the secretary of state have addressed fully the improper activities identified in this report. Thus, the California State Auditor made no recommendations to them.





# Probationers' Domestic Violence Payments

## Improved Processes for Managing and Distributing These Payments Could Increase Support for Local Shelters

### REPORT NUMBER 2011-121, ISSUED SEPTEMBER 2012

This report concludes that improved processes for managing and distributing payments collected from individuals convicted of crimes of domestic violence and sentenced to probation (probationers) could increase support for local shelters. Our review of 135 domestic violence cases in four California counties—Los Angeles, Sacramento, San Diego, and Santa Clara—over a four-year period revealed that individual courts and county agencies use varying methods for collecting the payments required of probationers. Of the cases we evaluated, many of the amounts initially assessed against probationers were not collected, although collections in some counties were higher than others. Moreover, our review of the distribution of funds from the payments identified several issues that reduced the amount of funding available to local shelters. Specifically, Santa Clara County had a fund balance that grew to \$715,000 in undistributed domestic violence funds. Sacramento County accumulated a large balance equivalent to 20 months of disbursements. Further, counties and courts inaccurately distributed the state and county shares of their domestic violence funds leading them, in some instances, to misdirect funds that they should have distributed to local shelters. When county agencies and courts do not collect or distribute all available domestic violence funds, local shelters may not be able to provide as many services to victims of domestic violence as they otherwise would. Finally, we identified several other issues that can affect these payments and that may require legislative clarification.

In the report, the California State Auditor (state auditor) made the following recommendations to Los Angeles County, the Los Angeles County Superior Court (Los Angeles Court), Sacramento County, San Diego County, the San Diego County Superior Court (San Diego Court), Santa Clara County, and the Legislature. The state auditor's determination regarding the current status of recommendations is based on the entities' responses to the state auditor as of November 2012.

#### **Recommendation 1.1.a—See pages 24—28 of the audit report for information on the related finding.**

To ensure consistent assessment, collection, and allocation of domestic violence payments, the Legislature should consider clarifying whether it intends for the domestic violence payment to be a fine or a fee and, similarly, whether collections entities should allocate the domestic violence payment to the payment priority category known as *finer and penalty assessments* or whether the payments belong in the *other reimbursable costs* category.

#### ***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012, to clarify these matters. However, shortly after our audit report was issued, Chapter 511, Statutes of 2012 (Assembly Bill 2094), was enacted. Among other things, it increases the minimum payment from \$400 to \$500. Further, if the court reduces or waives the payment at its discretion, the court is required to state the reason on the record.

#### **Recommendation 1.1.b—See pages 25—28 of the audit report for information on the related finding.**

To ensure consistent assessment, collection, and allocation of domestic violence payments, the Legislature should consider clarifying whether collections that belong in the *other reimbursable costs* category should be prorated among all assessments in that category.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 1.1.c—See pages 28 and 29 of the audit report for information on the related finding.**

To ensure consistent assessment, collection, and allocation of domestic violence payments, the Legislature should consider clarifying whether collections entities have the authority to continue pursuing collection of domestic violence payments once an individual's term of probation expires.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 1.1.d—See pages 29—31 of the audit report for information on the related finding.**

To ensure consistent assessment, collection, and allocation of domestic violence payments, the Legislature should consider clarifying whether allowable administrative costs apply to all funds in a county's special fund.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 1.1.e—See pages 29—31 of the audit report for information on the related finding.**

To ensure consistent assessment, collection, and allocation of domestic violence payments, the Legislature should consider clarifying how counties should calculate allowable administrative costs. Specifically, the Legislature should indicate whether counties should base their calculations on the balance of the special fund or deposits into that fund.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 1.2—See pages 20 and 21 of the audit report for information on the related finding.**

San Diego Court should ensure that procedures are in place so that courts do not reduce or waive domestic violence payments for reasons other than a probationer's inability to pay.

***San Diego Court's Action: Partially implemented.***

San Diego Court indicated that court administration discussed the audit findings with the court's judicial leadership. According to San Diego Court, the San Diego criminal justice community has approached the problem of domestic violence collaboratively over the years and has consistently urged the court to treat the completion of the mandatory counseling and treatment as a priority. Further, it explained that the prosecution and defense routinely agree to use a financial incentive-based approach to help ensure the defendant's timely completion of the 52-week Domestic Violence Recovery Program. It indicated that due to the audit findings, San Diego Court is now aware of the conflict that this plea-bargained, or agreed-upon, approach has created, especially in light of the effort to increase collection of the domestic violence fund fees. According to San Diego Court, its judicial leadership has indicated that it will embark on an effort to address the issues with its criminal justice partners, which are both the prosecution and defense bar.

**Recommendation 1.3.a—See pages 21—23 of the audit report for information on the related finding.**

To ensure that it is accurately setting up accounts and to ensure that probationers are not paying more fines and fees than are applicable, San Diego Court should include on the orders issued at sentencing the breakdown of all fines and fees owed.

***San Diego Court's Action: Pending.***

According to San Diego Court, staff are working to amend its change-of-plea form to list each fee and fine and to include a space for the amount of each. The court expects to have the changes approved and implemented by January 2013.

**Recommendation 1.3.b—See pages 21—23 of the audit report for information on the related finding.**

To ensure that it is accurately setting up accounts and to ensure that probationers are not paying more fines and fees than are applicable, San Diego Court should use the guidelines in place at the time of sentencing for those convicted of domestic violence crimes when it establishes accounts for payments.

***San Diego Court's Action: Partially implemented.***

San Diego Court indicated that accounting staff, who open accounts receivable, are now opening accounts on domestic violence cases at the time of sentencing, even if the fines have been stayed pending completion of a program, rather than waiting until the fines and fees become due. According to San Diego Court, the accounting staff are using current sentencing guidelines to ensure proper allocation of fines and fees. Further, San Diego Court explained that for older cases on which the fines and fees were stayed and an account has not yet been opened, staff are opening the accounts receivable as the stays are lifted and the fines and fees become due. It is working to create tools for staff to clearly show the proper allocations for the applicable sentencing dates. San Diego Court expects that full implementation will be complete no later than January 2013.

**Recommendation 2.1—See page 41 of the audit report for information on the related finding.**

The Legislature should consider clarifying whether it intends for collections entities to base the percentage of domestic violence payment revenue distributed to the State and county on statutes in effect at the time of sentencing or at the time the probationer makes a payment.

***Legislative Action: Unknown.***

The state auditor is not aware of any action taken by the Legislature as of December 18, 2012.

**Recommendation 2.2—See pages 35—38 of the audit report for information on the related finding.**

Santa Clara County should implement a process to distribute funds regularly to domestic violence shelters.

***Santa Clara County's Action: Partially implemented.***

Santa Clara County developed a process for annually distributing funds to domestic violence shelters, which includes an annual Request for Statements of Qualifications to certify any domestic violence shelter providers to receive funding for the next fiscal year. According to Santa Clara County, the fund distribution will be based on a formula that has been developed by the county with input from the shelter providers. Santa Clara County indicated that it will begin using this process for funds distributed during fiscal year 2013–14.

**Recommendation 2.3.a—See pages 38 and 39 of the audit report for information on the related finding.**

Sacramento County should finalize work with the State Controller's Office on correcting the county's overpayment of domestic violence funds to the State.

***Sacramento County's Action: Fully implemented.***

Sacramento County stated that it had completed the corrections to its distributions for the full three-year period, excluding the eight months in 2010 where there were no overpayments. It indicated that the final corrections totaled \$45,036 for these years. Sacramento County made the adjustments during its July 2012 and August 2012 distributions to the State.

**Recommendation 2.3.b—See pages 38 and 39 of the audit report for information on the related finding.**

Sacramento County should implement the process developed for reviewing statutes that affect domestic violence payment collection and distribution practices in order to prevent overpayment of domestic violence funds in the future.

***Sacramento County's Action: Fully implemented.***

Sacramento County established a policy for reviewing statutes that affect domestic violence payment collection and distribution practices. This policy requires Sacramento County to review all statutes related to the distribution of fines each December using the State of California's Legislative Information Web site.

**Recommendation 2.4.a—See pages 39—41 of the audit report for information on the related finding.**

Los Angeles County, San Diego County, San Diego Court, and Santa Clara County should determine the magnitude of the misdirected domestic violence funds.

***Los Angeles County's Action: Fully implemented.***

Los Angeles County determined that its Probation Department overdistributed \$12,620 to the county for the period January through August 2010 and overdistributed \$883 to the State from August 2010 through June 2012. These adjustments net to a total of \$11,737 that it overpaid the county.

***San Diego County's Action: Fully implemented.***

San Diego County indicated that it reviewed and reconciled its records for all distributed funds and calculated that it underpaid the State \$4,300.

***San Diego Court's Action: Fully implemented.***

San Diego Court stated that it reviewed the domestic violence fund revenue distributions for the four court divisions with particular emphasis placed on distributions beginning in January 2010 and going forward since the audit report noted discrepancies within the central division during this period. After the review, San Diego Court calculated an overall net overpayment of \$203 to the State for the period January 2010 through October 2012 for all four divisions.

***Santa Clara County's Action: Partially implemented.***

According to Santa Clara County, its Department of Revenue is currently testing programming changes necessary to correct the 482 cases that make up the overpayment to the State. Santa Clara County anticipated these changes would be ready by the end of November 2012.

**Recommendation 2.4.b—See pages 39—41 of the audit report for information on the related finding.**

Los Angeles County, San Diego County, San Diego Court, and Santa Clara County should consult with the State Controller's Office to determine what action should be taken to correct the domestic violence funds that were misdirected in prior fiscal years.

***Los Angeles County's Action: Fully implemented.***

In October 2012 Los Angeles County submitted an adjustment of the \$11,737 that it overpaid the county.

***San Diego County's Action: Fully implemented.***

San Diego County offset county collections received in its regular disbursements in July, August, and September 2012 to adjust for the \$4,300 that it underpaid the State.

***San Diego Court's Action: Pending.***

San Diego Court indicated that its accounting staff will make an adjustment in December 2012 to correct the net overpayment to the State.

***Santa Clara County's Action: Partially implemented.***

Santa Clara County indicated it has contacted the State Controller's Office and will correct the prior distributions once it completes its testing of necessary programming changes.

**Recommendation 2.4.c—See pages 39—41 of the audit report for information on the related finding.**

Los Angeles County, San Diego County, San Diego Court, and Santa Clara County should improve protocols for reviewing statutes that affect collection and distribution practices so that future changes can be acted upon.

***Los Angeles County's Action: Partially implemented.***

Los Angeles County indicated that its Probation Department will monitor the State Controller's Office's Web site monthly for updates to the Trial Court Manual and Distribution guidelines. However, although monitoring changes to statutes posted by the State Controller's Office is a valuable tool for identifying any relevant changes, this source may not be updated consistently. As a result, Los Angeles County could miss important statutory changes. We would expect Los Angeles County to develop a process to monitor the statutes itself to identify any relevant changes.

***San Diego County's Action: Partially implemented.***

San Diego County stated that it revised its accounting procedures following the completion of the audit to ensure compliance with statutes. It plans to have revised comprehensive procedures with a targeted completion date of March 2013 for all accounting processes that are affected by court ordered debt, including the domestic violence payment. San Diego County also plans to establish a compliance unit by the end of January 2013. This unit will be responsible for regular and ongoing monitoring of procedures and for ensuring that all legislative changes are reflected in the procedures.

***San Diego Court's Action: Partially implemented.***

According to San Diego Court, its accounting staff will continue to work with the court legislative analyst and Administrative Office of the Courts' staff to keep abreast of legislative changes impacting revenue distributions. San Diego Court anticipates that legislative updates can be added as an agenda item on future Accounting Committee meetings.

***Santa Clara County's Action: Partially implemented.***

Santa Clara County explained that it, together with the Santa Clara Superior Court, has formed a Legislation Review Committee. The members of the committee are to monitor new legislation and discuss changes to departmental procedures. Santa Clara County stated this will include information on the change of the amount collected from \$400 to \$500 effective January 1, 2013, due to the recent passage of Assembly Bill 2094 by the Legislature.

**Recommendation 2.5.a—See page 40 of the audit report for information on the related finding.**

Los Angeles Court should finalize the correction of the court's misdirected domestic violence funds.

***Los Angeles Court's Action: Fully implemented.***

Los Angeles Court stated that it has finalized and completed correction of its misdirected funds on the March 2012 and July 2012 monthly revenue distribution of funds to the State. Documentation from the Los Angeles Court indicated that it made an adjustment for \$7,289 that it overpaid the State.

**Recommendation 2.5.b—See page 40 of the audit report for information on the related finding.**

Los Angeles Court should improve protocols for reviewing statutes that affect collection and distribution practices so that future changes can be acted upon.

***Los Angeles Court's Action: Fully implemented.***

Los Angeles Court established a checklist to ensure that all areas affecting revenue distribution are changed consistently throughout the cashiering and revenue distribution systems.

**Recommendation 2.6—See pages 41—43 of the audit report for information on the related finding.**

Sacramento County should increase its contracted spending for shelter services so that it reduces the balance of its special fund down to a level that is reasonable considering the needs of the fund.

***Sacramento County's Action: Fully implemented.***

Sacramento County obtained its board of supervisors' approval in November 2012 to increase its contracted spending for shelter services by more than \$400,000 to provide additional domestic violence services and crisis intervention through June 2014. Further, it obtained approval to issue a Request for Interest for an additional \$100,000 to contract with providers of domestic violence services to underserved populations.

**Recommendation 2.7—See pages 41—44 of the audit report for information on the related finding.**

To ensure that they are maximizing the impact of domestic violence funds, Sacramento, San Diego, and Santa Clara counties should periodically monitor their special funds.

***Sacramento County's Action: No action taken.***

➡ Sacramento County did not respond to this recommendation.

***San Diego County's Action: Partially implemented.***

San Diego County indicated that it will conduct an annual review of the balance in the fund and compare it with the rate of incoming funds quarterly. According to San Diego County, this process will be implemented in November 2012 and calculations will be made retroactively for the first quarter.

***Santa Clara County's Action: Fully implemented.***

Santa Clara County developed a formula for distributing funds annually to the local domestic violence shelters based on the funds available in the domestic violence trust fund. Use of this formula will require that Santa Clara County determine the balance of its funds.





# Los Angeles County Department of Children and Family Services

## Management Instability Hampered Efforts to Better Protect Children

### REPORT NUMBER 2011-101.2, ISSUED MARCH 2012

This report concludes that instability in the Department of Children and Family Services' (department) management has hampered its efforts to address long-standing problems. Since 2009 the department has struggled to complete investigations of child abuse and neglect within requisite time frames. In July 2010 the department reported it had 9,300 investigations that were open longer than 30 days, the maximum time period allowed by state regulations. Although this backlog has decreased substantially, it remains at a relatively elevated level. Department officials indicated that it contributed to the backlog in uncompleted investigations when, under pressure from outside stakeholders, department management created new, potentially unrealistic policies that it later revised or rescinded in early 2011. Nevertheless, in January 2012 the backlog was still 3,200, more than twice as large as it was in July 2009.

The department has also struggled to perform required assessments of homes and caregivers prior to placing children with relatives. From 2008 to 2010 the department completed fewer than a third of home and caregiver assessments before placing children with relatives. This delay resulted in nearly 900 children living in placements that the department later determined to be unsafe or inappropriate. Even after these determinations, the children typically remained in these homes for nearly a month and a half before the department removed them, or later reassessed and approved the placement. Department management failed to identify and address this long-standing problem because it has not monitored whether required assessments are completed prior to placement.

Finally, in just over a year, the department had four different directors. It has also experienced high turnover in other key management positions. This turnover impeded the department's ability to develop and implement a strategic plan that would have provided cohesiveness to its various initiatives and communicated a clear vision to department staff and external stakeholders.

In the report, the California State Auditor (state auditor) made the following recommendations to the department. The state auditor's determination regarding the current status of recommendations is based on the department's response to the state auditor as of September 2012.

#### **Recommendation 1.1.a—See pages 15—20 of the audit report for information on the related finding.**

To ensure that child abuse and neglect allegations receive timely resolution, the department should continue to monitor the status of its backlog of investigations but revise its policies and performance measures to no longer define the backlog as investigations over 60 days old. Rather, it should emphasize completing investigations within 30 days.

#### ***Department's Action: Fully implemented.***

The department created a goal to reduce the number of referral investigations that take longer than 30 days. In accordance with this goal, the department states that its regional managers will monitor how many investigations take longer than 30 days.

#### **Recommendation 1.1.b—See pages 15—20 of the audit report for information on the related finding.**

To ensure that child abuse and neglect allegations receive timely resolution, the department should assess whether it needs to permanently allocate more resources to investigate allegations of child abuse and neglect.

***Department's Action: Pending.***

The department states it is currently assessing the caseload levels for social workers who investigate allegations of child abuse and neglect and is examining its processes to streamline its investigations.

**Recommendation 1.2—See pages 19 and 20 of the audit report for information on the related finding.**

To better ensure that inner-city regional offices are staffed by experienced social workers, the department should consider providing social workers with incentives to work in these areas or require them to remain in these offices for a period longer than the one year currently required.

***Department's Action: Fully implemented.***

The department has temporarily frozen transfers of social workers who work in inner-city offices. It has also notified future social workers, who will be assigned to inner-city offices, that they will be expected to remain in those offices for at least two years. Additionally, the department is attempting to provide financial incentives to social workers who work in inner-city regional offices.

**Recommendation 2.1—See pages 25—30 of the audit report for information on the related finding.**

To ensure that it is placing children only in safe homes, the department should measure its performance and adjust its practices to adhere to state law, which requires that all homes be assessed prior to the placement of the child.

***Department's Action: No action taken.***

- The department disagrees with our interpretation of state law; it believes it does not need to complete formal assessments of caregivers and homes before placing children in homes. As described in our comments on pages 81 through 84 of the audit report, we strongly disagree with the department's interpretations.

**Recommendation 2.2—See pages 25—30 of the audit report for information on the related finding.**

To improve its process for placing children with a relative, the department should analyze the best practices used by other county child welfare services agencies for such placements. The department should then implement changes in its practices so that relatives and their homes are approved prior to placement, as required by state law.

***Department's Action: No action taken.***

- The department indicates that it researched the practices of five other counties but the department believes that its relative placement process conforms to regulations and has not made the changes we recommended.

**Recommendation 2.3—See pages 33 and 34 of the audit report for information on the related finding.**

To ensure that social workers have as much relevant information as possible when placing children and licensing homes, the department should report requisite allegations of abuse or neglect to the Department of Justice and the Department of Social Services' licensing division.

*Department's Action: Fully implemented.*

The department implemented a process that will make it easier to submit the requisite reports to the Department of Justice. Instead of faxing reports, the department's employees can now click on an icon that will transmit the report electronically. Additionally, the department reminded staff regarding their responsibility for submitting these reports.

**Recommendation 2.4—See pages 35—37 of the audit report for information on the related finding.**

To fully benefit from its death review process, the department should implement the resulting recommendations.

*Department's Action: Pending.*

The department is working with its legal counsel to determine how it can best implement this recommendation.

**Recommendation 3.1—See pages 39—42 of the audit report for information on the related finding.**

To provide effective leadership, the director should form a stable executive team by filling the department's chief deputy director, senior deputy director, and other deputy director positions.

*Department's Action: Partially implemented.*

The director has filled the senior deputy director, director of program development and strategic initiatives, and executive assistant positions. The director also indicated that he plans to fill the other positions after a planned reorganization occurs.

**Recommendation 3.2—See pages 39—42 of the audit report for information on the related finding.**

To create and communicate its philosophy and plans, the department should complete and implement its strategic plan.

*Department's Action: Partially implemented.*

The department distributed the completed strategic plan in September 2012, which contained 50 objectives. To implement these objectives, the department will create action teams that consist of executive sponsors and project managers.



# Salinas Valley Memorial Healthcare System

## Increased Transparency and Stronger Controls Are Necessary as It Focuses on Improving Its Financial Situation

### REPORT NUMBER 2011-113, ISSUED MARCH 2012

This report concludes that the Salinas Valley Memorial Healthcare System's (Health Care System) board of directors (board), when making decisions regarding executive compensation, violated the Ralph M. Brown Act, which requires legislative bodies of local public agencies to conduct their meetings in an open manner. In an environment characterized by a lack of an executive compensation policy and limited transparency, the Health Care System granted compensation for its executives at the upper end of the range for the health care industry. In addition, the former chief executive officer (CEO) received generous retirement and severance benefits totaling \$4.9 million between 2008 and 2011, most of which were paid to him before he retired.

Our review also noted weaknesses in controls in several areas. We identified 11 instances in which the Health Care System had business relationships between 2006 and 2010 with entities in which its executives or board members had economic interests. In the two relationships we reviewed, the former CEO may have violated conflict-of-interest laws in one instance, and the board may have violated conflict-of-interest laws in the other instance. Also, the Health Care System did not ensure that many of the individuals its conflict-of-interest code identified as needing to submit statements of economic interests did so. Further, it does not have a written policy and procedures to demonstrate that its community funding furthers its public purposes, thereby risking questions about whether this funding violates the constitutional prohibition against public agencies making gifts of public funds. Additionally, for contracts we reviewed for which it was not required by state law to use a competitive process, the Health Care System generally did not document how it selected contractors in a way that demonstrated that it obtained the best value when procuring goods and services.

Finally, we noted that the Health Care System has undertaken several initiatives to improve its financial situation, including reducing its staff by 341 positions between July 2010 and October 2011. Even though it reduced its staffing, there is no indication that this decrease affected patient quality of care, as reflected by complaints and similar measures.

In the report, the California State Auditor (state auditor) made the following recommendations to the Health Care System. The state auditor's determination regarding the current status of recommendations is based on the Health Care System's response to the state auditor as of September 2012.

#### **Recommendation 1.1.a—See page 16 of the audit report for information on the related finding.**

To provide members of the public with opportunities to meaningfully participate in board meetings regarding executive compensation matters, and to hold the board accountable for its decisions on these matters, the Health Care System should develop a formal policy that establishes a process for determining executive compensation, including retirement benefits, that clearly documents all executive compensation decisions.

#### ***Health Care System's Action: Fully implemented.***

The board adopted an executive compensation policy in July 2012 that defines the Health Care System's process for establishing executive compensation and requires that compensation, including benefits, for the CEO shall be approved by the board in open sessions of board meetings. Similarly, this policy requires that the board approve salary scales and benefits for executives other than the CEO in open sessions. The policy also specifies that the CEO has the authority to set salaries for other executives and must report the salaries he or she sets to the board.

**Recommendation 1.1.b—See pages 16—19 of the audit report for information on the related finding.**

To provide members of the public with opportunities to meaningfully participate in board meetings regarding executive compensation matters, and to hold the board accountable for its decisions on these matters, the Health Care System should clearly indicate compensation matters on the agendas for its board meetings.

***Health Care System's Action: Fully implemented.***

The Health Care System's updated executive compensation policy requires that matters concerning compensation for the CEO or other executives must be specified in agendas and/or minutes for board meetings. In addition, review of the agendas for board meetings in May through August 2012 indicate that the Health Care System is following this policy.

**Recommendation 1.1.c—See pages 16—19 of the audit report for information on the related finding.**

To provide members of the public with opportunities to meaningfully participate in board meetings regarding executive compensation matters, and to hold the board accountable for its decisions on these matters, the Health Care System should discuss executive compensation matters only in open sessions of board meetings, except in the limited circumstances that allow for discussion in closed sessions.

***Health Care System's Action: Fully implemented.***

The Health Care System's executive compensation policy specifies that the CEO's compensation, including benefits, the CEO's employment agreement, and salary scales and benefits for executive positions other than the CEO shall be approved by the board in open session, and discussion of these compensation matters may occur in closed session only in the limited circumstances specified in law. The Health Care System's board agendas and minutes for May through August 2012 indicate the board is adhering to its executive compensation policy.

**Recommendation 1.2—See pages 19 and 20 of the audit report for information on the related finding.**

To ensure that the terms of its CEO's employment and compensation are clear, and to aid the board in its oversight role, the Health Care System should engage its next permanent CEO in a written employment contract.

***Health Care System's Action: Fully implemented.***

According to the Health Care System's executive compensation policy, its permanent CEO, when hired, will be engaged in an employment agreement. In addition, in its six-month response, the Health Care System indicated that it now requires employment contracts for all of its executives, including the CEO, and that it executed an employment contract with its chief operating officer. Moreover, Chapter 322, Statutes of 2012 (Assembly Bill 2180), requires that a written employment agreement entered into with a hospital administrator by a local health care district include all material terms and conditions regarding compensation and benefits agreed to by the district and the hospital administrator. In addition, the governor vetoed Assembly Bill 2115 of the 2011–12 Regular Legislative Session on September 13, 2012. This bill if enacted, would have required, rather than permitted, local health care districts to enter into written employment agreements not to exceed four years when hiring a hospital administrator or CEO.

**Recommendation 1.3—See pages 27 and 28 of the audit report for information on the related finding.**

To help reduce its operating costs and improve its overall financial situation, the Health Care System should continue to try to modify its employee benefits, such as paid time off, so they are aligned with industry practice.

***Health Care System's Action: Pending.***

In its six-month response, the Health Care System stated that in light of current union contracts, it is challenged with balancing nonunion benefits to union benefits to ensure it is able to retain qualified employees and candidates. Nonetheless, the Health Care System indicated that its executive leadership team and the board continue to evaluate opportunities to shift this variance between the Health Care System's employee benefits and industry practice.

**Recommendation 2.1.a—See pages 32—37 of the audit report for information on the related finding.**

To ensure that the Health Care System, its board members, medical staff, employees, and consultants are engaged only in appropriate business relationships with respect to their economic interests, the Health Care System should engage an independent investigator to review the Health Care System's business relationships with entities that we identified as being economic interests of its board members and executives to determine whether any of the relationships violate applicable legal prohibitions and take appropriate corrective action if they do.

***Health Care System's Action: Partially implemented.***

The Health Care System engaged a law firm to conduct an independent investigation of its relationships with business entities we identified in our report as economic interests of the Health Care System's board members and executives. According to a general summary of the law firm's findings, it found that seven of the nine relationships it examined did not violate any applicable legal prohibitions; for the other two relationships, one of them had ceased and in the other the affected employee or official no longer has a financial interest in the entity. Consequently, according to the law firm, no corrective action was required for any of the nine relationships. However, the law firm also indicated it detected some issues during its investigation and analysis that raised concerns regarding the manner in which the Health Care System identified and addressed potential conflicts of interest. As a result of these issues, the law firm indicated it is working with the Health Care System to implement systems to address these concerns in order to prevent similar issues in the future.

**Recommendation 2.1.b—See pages 32—37 of the audit report for information on the related finding.**

To ensure that the Health Care System, its board members, medical staff, employees, and consultants are engaged only in appropriate business relationships with respect to their economic interests, the Health Care System should implement the requirement in its recently updated conflict-of-interest policy that board members, medical staff, employees, and consultants disclose potential conflict-of-interest situations to their supervisors and the ethics and compliance officer, who shall review each situation and make a determination on the appropriate resolution.

***Health Care System's Action: Fully implemented.***

According to the Health Care System, 24 individuals who submitted statements of economic interests for 2011 identified financial interests in their statements. The revenue integrity and compliance director determined based on her review of the 24 statements that 11 of them required further discussion between the individuals and either the revenue integrity and compliance director or the individuals' supervisors. Following these discussions, according to the revenue integrity and compliance director, she determined no actual violations of conflict-of-interest laws occurred in 2011. In addition, all 24 individuals understood that moving forward they needed to be alert for potential conflicts of interest associated with their identified financial interests.



**Recommendation 2.2—See pages 37 and 38 of the audit report for information on the related finding.**

To ensure that it has an up-to-date, approved conflict-of-interest code, the Health Care System should develop a protocol to file an action through the superior court to adopt a code if, in the future, the board of supervisors does not approve a code within six months of one being submitted to it by the Health Care System and if follow-up efforts with the board of supervisors prove unsuccessful.

***Health Care System's Action: Fully implemented.***

The Health Care System amended its conflict-of-interest policy to specify that if the board of supervisors does not approve changes proposed by the Health Care System's conflict-of-interest code within six months of submission, then the Health Care System will seek legal counsel to consider potential superior court action to ensure action by the board of supervisors.

**Recommendation 2.3.a—See pages 38—41 of the audit report for information on the related finding.**

To help ensure that individuals designated by the Health Care System as needing to file statements of economic interests do so, the Health Care System should amend its conflict-of-interest policy to specify an individual as its filing officer, in accordance with guidelines of the Fair Political Practices Commission.

***Health Care System's Action: Fully implemented.***

The Health Care System's amended conflict-of-interest policy specifies that its ethics and compliance officer, now called its revenue integrity and compliance director, serves as the filing officer for all positions designated in its conflict-of-interest code as needing to file statements of economic interests (designated filers).

**Recommendation 2.3.b—See pages 38—41 of the audit report for information on the related finding.**

To help ensure that individuals designated by the Health Care System as needing to file statements of economic interests do so, the Health Care System should amend its conflict-of-interest policy to delineate the steps its filing officer should take to ensure that all Health Care System board members, medical staff, employees, and consultants who are required to file statements of economic interests do so.

***Health Care System's Action: Fully implemented.***

The Health Care System's amended conflict-of-interest policy delineates the steps that the revenue integrity and compliance director will take to ensure that designated filers submit their statements of economic interests, including sending reminders to all designated filers, following up when individuals do not submit their statements, and reporting noncompliance to the Health Care System's executive leadership.

**Recommendation 2.3.c—See pages 38—41 of the audit report for information on the related finding.**

To help ensure that individuals designated by the Health Care System as needing to file statements of economic interests do so, the Health Care System should amend its conflict-of-interest policy to specify penalties for failure to file.



***Health Care System's Action: Fully implemented.***

The Health Care System amended its conflict-of-interest policy to specify that individuals submitting their statements late are subject to progressive discipline and a fine of \$10 per day that the statements are late, up to a maximum fine of \$100. In addition, the policy states that designated filers whose statements are not received within 30 days of their due dates will be referred to the Fair Political Practices Commission for noncompliance enforcement proceedings.

**Recommendation 2.4—See pages 40 and 41 of the audit report for information on the related finding.**

To help ensure the accuracy and completeness of filed statements of economic interests, the Health Care System's filing officer should follow state regulations for reviewing submitted statements, including verifying the cover sheet for completeness for all submitted statements.

***Health Care System's Action: Fully implemented.***

The Health Care System's amended conflict-of-interest policy specifies that the revenue integrity and compliance director will review all submitted statements for overall completeness and general accuracy. In addition, in the Health Care System's six-month response, it indicated that in collecting and reviewing the statements for 2011, the revenue integrity and compliance director reviewed the cover sheets for all statements and ensured completion and submission of all appropriate schedules.

**Recommendation 2.5—See pages 41—43 of the audit report for information on the related finding.**

To ensure that it is not making gifts of public funds, the Health Care System should develop and implement a policy and written procedures to demonstrate how funds it provides to support entities and programs in the community further the Health Care System's public purposes.

***Health Care System's Action: Fully implemented.***

The Health Care System adopted a community funding policy to ensure that all Health Care System resources provided to any individual, organization, or entity are expended for the public purpose of its mission of improving health care. This policy includes procedures the Health Care System is to follow in evaluating and approving requests for community funding, and specifies that all Health Care System decisions related to community funding will be made pursuant to these procedures. The Health Care System also provided in its six-month response documentation that demonstrates it is following its new community funding policy and procedures.

**Recommendation 2.6—See page 43 of the audit report for information on the related finding.**

To help ensure that the Health Care System has the information it needs to comply with state regulations regarding public disclosure of the disposition of event tickets, the Health Care System should develop and implement a policy and written procedures for tracking its distribution of event tickets. The procedures should ensure that the Health Care System follows state requirements for making pertinent public disclosures.

***Health Care System's Action: Partially implemented.***

Included in the Health Care System's community funding policy is a policy regarding the disposition of event tickets. The policy specifies that when the Health Care System receives tickets or other benefits in response to providing community funding, the benefits shall be provided to the Salinas Valley Memorial Hospital Foundation (foundation). The policy also indicates that the foundation is responsible for maintaining all records related to the distribution of all tickets and benefits. However, it does not appear that the Health Care System's policy regarding ticket disposition is adequate to ensure it complies with applicable state reporting requirements because, among other things, the policy does not ensure that the Health Care System's provision of tickets to the foundation will be publicly disclosed.

**Recommendation 2.7—See pages 45—47 of the audit report for information on the related finding.**

To increase the transparency of its processes for awarding contracts that are not required by law to be selected using a competitive process, the Health Care System should require its employees to fully document the steps they take in selecting contractors and to describe how the selections result in the best value to the Health Care System.

***Health Care System's Action: Partially implemented.***

The board adopted a revised procurement management policy in June 2012 that directed the Health Care System's executive leadership group to adopt a procurement manual that incorporates, clarifies, and coordinates all Health Care System procurement policies. The Health Care System is in the process of drafting a procurement manual that will include guidance and requirements for Health Care System employees to follow when making all organizational procurements. The guidance and requirements in the procurement manual will address the steps Health Care System staff should follow to document and describe how their selections of contractors result in the best value. The procurement manual is currently being completed and reviewed by legal counsel, with anticipated completion by the end of 2012. According to the revenue integrity and compliance director, the Health Care System started providing training at the department director level on the new procurement policies and procedures since May 2012.

## State Controller's Office

### Failure to Report Absences, Failure to Monitor Adequately an Employee's Time Reporting (Case I2009-1476)

#### REPORT NUMBER I2011-1, CHAPTER 7, ISSUED AUGUST 2011

This report found that an employee of the State Controller's Office (Controller's Office) failed to report an estimated 322 hours of absences over an 18-month period. Because her supervisor, a high-level official, failed to monitor adequately her time reporting, the State paid the employee \$6,591 for hours she did not work.

In the report, the California State Auditor (state auditor) made the following recommendations to the Controller's Office. The state auditor's determination regarding the current status of recommendations is based on the Controller's Office's response to the state auditor as of September 2011.

#### **Recommendation 1.a—See pages 44—46 of the investigative report for information on the related finding.**

To address the employee's improper time reporting, the Controller's Office should seek reimbursement from the employee for the wages she did not earn.

#### *Controller's Office's Action: Fully implemented.*

The Controller's Office reported that before the employee's retirement in August 2010, it subtracted approximately 21 days from her leave balance, equaling \$3,613 in gross payments, and applied this leave to the employee's unauthorized time off. In addition, it established an accounts receivable for the balance of the unauthorized leave, and it notified the employee of the remaining \$2,978 owed to the State. In August 2011 the Controller's Office told us that the employee had repaid the amount owed.

#### **Recommendation 1.b—See page 46 of the investigative report for information on the related finding.**

To address the supervisor's failure to monitor the employee's time adequately, the Controller's Office should take appropriate disciplinary action against the supervisor.

#### *Controller's Office's Action: Fully implemented.*

The Controller's Office informed us that management representatives counseled the official because it acknowledged that the official was responsible for monitoring the employee's time and that he provided insufficient oversight. It also stated that because the official's busy schedule did not allow him to monitor adequately his support staff's time, his staff was placed under the direct supervision of an office manager effective August 2010.

#### **Recommendation 1.c—See pages 43—46 of the investigative report for information on the related finding.**

The Controller's Office should provide training to the supervisor on proper time-reporting and supervisory requirements.

#### *Controller's Office's Action: Fully implemented.*

The Controller's Office reported that its chief of Human Resources provided the supervisor with additional training on proper time-reporting and related supervisory requirements. It also provided evidence to us that it had conducted training for all supervisors on proper time-reporting and related supervisory requirements.

