REPORT BY THE

AUDITOR GENERAL

OF CALIFORNIA

A DISCUSSION OF THE DEPARTMENT OF REHABILITATION'S DECISION TO SUSPEND SERVICES TO THE DISABLED DURING FISCAL YEAR 1980-1981

During September 1980, the Department of Rehabilitation suspended most rehabilitation services to new applicants. This suspension of services, which lasted up to three months, may have had detrimental effects on some disabled individuals. As a result, we were asked to investigate a number of matters related to why the department chose to suspend services; whether the department's decision to suspend services was based upon accurate projections of available funds and expenditures; and why management delayed taking action to reduce expenses when financial problems had been suspected at a much earlier date.

P-038

JANUARY 1982

REPORT OF THE

OFFICE OF THE AUDITOR GENERAL

TO THE

JOINT LEGISLATIVE AUDIT COMMITTEE

038

A DISCUSSION OF THE DEPARTMENT OF REHABILITATION'S DECISION TO SUSPEND SERVICES TO THE DISABLED DURING FISCAL YEAR 1980-81

JANUARY 1982

California Legislature

Joint Legislative Audit Committee

925 L STREET, SUITE 750
SACRAMENTO, CALIFORNIA 95814
(916) 445-0371

WALTER M. INGALLS
CHAIRMAN

January 15, 1982 038

The Honorable President pro Tempore of the Senate
The Honorable Speaker of the Assembly
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's report concerning the Department of Rehabilitation's decision to suspend services to new clients during fiscal year 1980-81.

Respectfully submitted,

WALTER M. INGALLS
Chairman, Joint Legislative
Audit Committee

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SUMMARY

We have reviewed the circumstances surrounding the Department of Rehabilitation's decision to suspend rehabilitation services to certain disabled Californians in September 1980.

The department's primary goal is to rehabilitate and place physically and mentally handicapped persons in suitable employment. In response to reduced federal grants and increased salary costs, the department took several actions to reduce costs in fiscal year 1980-81. These actions include continuing the department's hiring freeze in July 1980 and implementing specific controls over expenditures for rehabilitation services in August 1980. And finally, after projecting a shortage of federal funds for the year, the department suspended most rehabilitation services to new applicants for up to three months beginning in September 1980. This report examines three main issues related to these actions.

First, we examined why the department chose to suspend services. We found that department officials suspended most rehabilitation services for new clients to assure that funds would be available to meet commitments to individuals who were already undergoing rehabilitation.

Next, we assessed whether management had based its decision to suspend services upon accurate projections of the department's financial condition. During September 1980, the department projected that it would run out of funds by mid-March 1981. However, instead of running out of funds, the department ended fiscal year 1980-81 with approximately $9.1 million in unspent funds. We concluded that the department's projection failed to predict accurately the outcome of the department's operations because the department overestimated the number and the cost of rehabilitation plans implemented during the year.

Finally, we examined why management delayed reacting to suspected financial problems. We found that the department was slow in reacting to suspected financial problems because management was anticipating additional federal grants.

INTRODUCTION

In response to a request by the Joint Legislative Audit Committee, we have reviewed the circumstances surrounding the Department of Rehabilitation's decision to suspend rehabilitation services to certain disabled Californians in September of 1980. This review was conducted under the authority vested in the Auditor General by Sections 10527 and 10528 of the Government Code.

Background

State and federal laws designate the State Department of Rehabilitation as the sole state agency responsible for supervising the provision of public vocational rehabilitation services to the disabled population in California.

The department's primary goal is to rehabilitate and to place in suitable employment persons who are physically and mentally handicapped. The department delivers these rehabilitation services to the disabled community through 26 district offices located throughout the State. At these district offices, rehabilitation counselors evaluate an applicant's potential for successful rehabilitation, determine the applicant's eligibility, and, in joint effort with the disabled person, develop an individualized rehabilitation plan. This plan identifies the specific education, training, equipment, and materials required to prepare the rehabilitation client for employment. The department implements the plan by providing the specified services either by purchase or by coordinating community resources. After the rehabilitation client has completed the rehabilitation program, the department helps the client find suitable employment.

In addition to the department's primary goal of rehabilitating individuals, it has established a number of other programs. These include (1) providing work activities for developmentally disabled individuals, (2) assisting the disabled in gaining independence, (3) promoting and expanding employment opportunities for the disabled, (4) removing architectural and transportation barriers to the disabled, and (5) developing new and innovative ways of serving the disabled through workshop services and special projects.

Funds from federal grants provide the primary support for the department's programs. The department spent approximately $133 million in fiscal year 1980-81. Approximately 61 percent of these expenditures were supported by federal grant funds, 37 percent were financed by the State's General Fund, and 2 percent were expenditures of other miscellaneous funds.

Each year, when preparing its budget, the department must estimate the amount of federal funds that it will have available for expenditure. Available federal funds are composed of two elements: amounts granted for the current state fiscal year and any unspent amounts left over from the preceeding state fiscal year, called carryovers.

Scope and Methodology

The purpose of our review was to confirm the department's financial condition during fiscal year 1980-81 and to address the issues that were raised in the request for this study. To accomplish these objectives, we reviewed the department's accounting records to determine the amount of federal grant funds actually available during fiscal year 1980-81. In addition, we reviewed department files to identify the basis for the department's decision to reduce expenditures and suspend rehabilitation services. Further, we interviewed department officials to determine their methods for projecting available federal funds and program expenditures. We also contacted federal officials to confirm certain past events surrounding the allocation of federal grants that caused the department to delay taking actions to reduce its expenditures. Finally, we reviewed the State Administrative Manual and interviewed Department of Finance personnel to identify applicable state budgetary procedures.

We did not audit the department's financial records and, therefore, do not express an opinion on them. The expenditure amounts contained in this report are, thus, based on unaudited data provided by the department. Further, we did not evaluate the department's effectiveness in reallocating federal grant funds among its various programs and activities.

STUDY RESULTS

In response to reductions in federal grants and increases in salary costs during fiscal year 1980-81, the Department of Rehabilitation instituted a number of cost-saving measures, including the suspension of most rehabilitation services to new applicants for up to three months. This reduction in services prompted questions about why the department decided to discontinue this primary service, whether the department's decision was based on accurate financial projections, and why the department delayed in implementing other cost-saving measures. In the first section, we describe the financial difficulties experienced by the department during fiscal year 1980-81. In the second section, we address the issues that arose as a result of the department's decision to suspend certain services.

THE DEPARTMENT'S FINANCIAL DIFFICULTIES DURING FISCAL YEAR 1980-81

During fiscal year 1980-81, the Federal Government reduced the amount of grant funds for rehabilitation allocated to California. Because it did not anticipate this reduction, the department budgeted $10.9 million more than it actually received. In addition, unbudgeted costs for salary and benefit increases compounded the department's financial problems. In

July 1980, at the very start of the 1980-81 fiscal year, the department's budgeted expenditures exceeded its estimated available funds by $14.9 million. To counterbalance these problems, the department took several actions to reduce its expenditures for the year.

Reduction of Federal Grant Funds

The Federal Government cut back its rehabilitation grant funds allocated to California for fiscal year 1980-81. Before fiscal year 1980-81, federal support of rehabilitation programs had been generally on the increase. The following table shows the total amounts of federal grants allocated for fiscal years 1977-78 through 1980-81.

TABLE 1

FEDERAL REHABILITATION GRANTS
FISCAL YEARS 1977-78 to 1980-81

Fiscal Year	Federal Grant Amounts[a] (In Millions)
1977-78	$79.4
1978-79	$84.0
1979-80	$86.5
1980-81	$82.5

[a] Because the state and the federal fiscal years do not coincide, the grant amounts shown here reflect the department's apportioning of federal grants for the state fiscal year.

The reduction in funds granted to California was primarily a result of nationwide cutbacks in rehabilitation funds by the U.S. Congress. The department did not anticipate this reduction in federal grants when it prepared its budget for fiscal year 1980-81. The department's budget prepared in approximately October 1979 projected federal grant amounts for fiscal year 1980-81. Estimated federal grants for fiscal year 1980-81 totaled approximately $93.4 million. However, the department received only $82.5 million in federal grants; this was $10.9 million less than it had anticipated.

Further, federal grant amounts were not officially made known until late in the fiscal year. During October 1980, more than three months into the state fiscal year, Congress failed to pass a full year's appropriation for 1980-81. At that time, Congress instead passed a temporary measure called a "continuing resolution" that authorized grant funds for only a three-month period. The total amount of federal grants for fiscal year 1980-81 was not officially established until June 26, 1981, four days before the end of the state fiscal year.

Increased Salary Costs

An increase in the cost of salaries also added to the department's financial problems. Effective July 1, 1980, Chapter 510, Statutes of 1980, authorized both a 9.75 percent general salary raise and an increase in employment benefits to state employees. These salary and benefit raises increased the department's total projected salary costs by $5.8 million for fiscal year 1980-81.

The department had not budgeted for this salary increase because state budgetary procedures instruct agencies to project payroll expenditures based upon current salary rates. When general salary increases are approved, they are funded separately by a special appropriation budgeted for by the Department of Finance. However, this appropriation covers only that portion of salary and benefit increases supported by state funds.

Department of Finance officials stated that it was the responsibility of the Department of Rehabilitation to obtain additional federal grants to cover the costs of salary increases not covered by the General Fund. Department of Rehabilitation officials point out, however, that additional federal funds were not available to them for this purpose. Further, they stated that, at the time the department's budget was first being formulated, they had anticipated increases in federal grants. Consequently, they thought that there would be sufficient federal funds to cover a general salary increase.

In addition to this budgeting problem, the department officials projected that salary costs increased another $2.1 million in December 1980 because the California Supreme Court granted a retroactive salary increase to state employees.

Major Cost-Saving Measures Instituted During Fiscal Year 1980-81

Because of reductions in federal grants and unbudgeted increases in salary costs, the department made significant cutbacks in its programs and operations during fiscal year 1980-81. The department continued its hiring freeze, placed restrictions on expenditures for clients, and finally suspended certain rehabilitation services for a three-month period. This final action may have prevented some individuals from achieving program goals and may also have extended some individuals' dependence on public assistance.

In July 1980, the department decided to continue a hiring freeze that had been in effect since January 1980. This hiring freeze was originally instituted to minimize the effect of a tax reduction initiative that, if approved by the voters, would have restricted the amount of state funds available to the department. The initiative was defeated in the June 1980 Primary Election.

Further, in August 1980, the department implemented specific controls over expenditures for clients. These policies included the following: (1) restricting vehicle purchases, expenditures for clients' subsistence, and on-the-job training; (2) controlling post-graduate education, self-employment objectives, and transportation expenditures, and (3) reducing the use of private schools.

Finally, in September 1980, the department suspended all efforts to develop and implement new plans, to continue extensive evaluations of eligibility, and to make major revisions of existing plans. This suspension lasted for approximately one and one-half months. At the end of this period, severely disabled individuals were allowed to receive rehabilitation services in accordance with the federally required "order-of-selection process." This process establishes priorities for providing services to clients according to their disability. In another month and one-half, the suspension was lifted entirely.

As a result of suspending its efforts to develop and implement rehabilitation plans, the department's waiting lists of eligible individuals grew and rehabilitation services to these individuals were thus delayed. We found, however, that the effect of these delays is uncertain.

There are potentially detrimental effects. Delays in providing rehabilitation services may have been disruptive to some individuals and may have extended the time that some clients needed to receive welfare assistance. Some rehabilitation counselors we talked to stated that the suspension of services disrupted their contact with the disabled applicants and that some of these applicants never returned for their rehabilitation training after the suspension was lifted. The suspension of services, therefore, may have prevented some individuals from achieving the benefits of rehabilitation--equal opportunity and independent living. Other clients were forced to wait for needed rehabilitation services.

Delayed services may not only be detrimental to the client but also to the State and Federal Governments. The department maintains that rehabilitated clients have substantially increased earning potential and are therefore less dependent upon institutionalization or public assistance. The department estimated that in fiscal year 1979-80, a rehabilitated client accounted for an average savings of $432 per year in welfare, medical, and social security costs. Additionally, these clients contributed an average of $1,542 per year to the public in increased federal income, state income, sales, and social security taxes.

On the other hand, department officials maintain that there were only minor detrimental effects caused by the suspension of services and that some individuals might have even benefited from the action. They stated that the disruption of services only extended the period for which new applicants must normally wait to receive services from approximately four months to five months. They further stated that some applicants sought services from some other public supported program, such as the Federal Comprehensive Employment and Training Act program (CETA). Finally, some individuals who were denied services were motivated to find a job on their own and, therefore, required no further assistance from the department.

ISSUES RAISED BY THE DEPARTMENT'S ACTIONS

In this section, we address the issues that have arisen because of the department's suspension of some rehabilitation services. First, we discuss the basis for the department's decision to suspend rehabilitation services. We then address the reasonableness of the department's financial projections. Finally, we explain why the department waited so long before taking action to control expenditures.

Reason for Suspending Most Rehabilitation Services to New Clients

The department suspended its efforts to develop and implement new rehabilitation plans during fiscal year 1980-81 because it projected that there would not be sufficient federal funds available to meet the department's commitments to individuals already receiving rehabilitation services.

On September 10, 1980, the department projected that if it continued to provide rehabilitation services to all clients, it would exhaust the available federal funds by mid-March 1981. Consequently, it would have to suspend rehabilitation services to all clients. Department officials stated that they decided to alleviate their projected deficit by suspending the development and implementation of plans for new clients. By taking this action, the department would ensure that sufficient federal funds were available to complete the rehabilitation of clients already receiving services. The officials stated that the department has a legal and moral obligation to complete a rehabilitation plan once it has been implemented. Provisions of the Federal Rehabilitation Act support this contention.

According to the Federal Rehabilitation Act of 1973, as amended, in the event that vocational rehabilitation services cannot be provided to all eligible handicapped individuals who apply for services, an order of selection process must be followed. According to federally established procedures, if an order of selection process is started, such as the one the department implemented in September 1980, the department must assure that priority is given to individuals already undergoing rehabilitation.

Accuracy of Projections for Available Federal Funds and Program Expenditures

The department suspended its efforts to implement rehabilitation plans for new applicants for three months during fiscal year 1980-81 because it estimated that there would be a $2.8 million shortage of available funds to pay for these services. This estimate has been questioned because the department ended the 1980-81 fiscal year with approximately $9.1 million in unspent funds. We found that the department did not accurately project the final outcome primarily because staff overestimated the number and cost of rehabilitation plans implemented during the year.

We compared a projection of available funds and estimated expenditures made when case services were suspended with funds actually received and expenditures actually made at the end of the fiscal year (see Appendix A).

We found that the major difference occurs in expenditures for case services. Case service expenditures represent the amount spent by the department for the purchase of rehabilitation services. Staff estimated that the department would spend $34.2 million for case services. Actual expenditures were $26.0 million. There are two primary reasons for this $8.2 million difference between projected and actual expenditures for case services. First, the department overestimated the number of rehabilitation plans that would be implemented during the year. Department staff projected implementing 20,473 plans for new clients, but produced only 18,140 plans. According to department officials, the department did not reach its projected number of rehabilitation plans because of the three-month suspension of services, the decline in production caused by reductions in staff, and the disruption in subsequent services resulting from the three-month suspension.

Second, in making its projections, the department overestimated the cost of rehabilitation services. The department projected expenditures for case services for fiscal year 1980-81 by using the average plan cost for the previous fiscal year, 1979-80. However, the actual cost per plan during fiscal year 1980-81 was significantly lower than that of the previous year. For example, the average actual cost for a new plan implemented during 1980-81 was $370.54; the average actual cost for fiscal year 1979-80 was $543.11.

Department officials attribute the reduction in the average cost per plan to the implementation of various cost-saving policies that were adopted beginning in August 1980. We found no evidence to indicate that the department could have accurately estimated the effect of these policies when it projected the $2.8 million deficit during September 1980.

Delays in Implementing
Cost-Saving Measures

Approximately five months lapsed between the time the department was aware of its potential financial problems and the time that it implemented major policies aimed at reducing rehabilitation costs. If the department had acted earlier, it may have alleviated the need to suspend certain rehabilitation services. Department officials stated that they hesitated to cut back rehabilitation services primarily because they expected the Congress to appropriate more funds than were initially promised by federal administrators.

The department was aware of both impending reductions in federal grants and impending increases in salary costs at least five months before the beginning of the 1980-81 state fiscal year. On January 31, 1980, the Federal Government notified the department of the estimated 1980-81 federal grant allocation. Grants were then estimated to total $86.5 million for the state fiscal year. This amount was $6.9 million less than the department had planned to spend according to its 1980-81 budget. Additionally, the department was made aware of pending salary and benefit increases for fiscal year 1980-81 on January 10, 1980, when the Governor proposed a 9 percent salary increase for state civil service employees.

In addition, the department received subsequent notices of further federal cutbacks and unbudgeted cost increases. By August 1980, the department projected that budgeted expenditures would exceed estimated available funds by $16.4 million. It was at about this time that the department's district offices implemented a number of cost-saving measures. Some of these measures had been proposed by executive staff members in November 1979 when the Federal Government reduced its earlier projections of grant funds for fiscal year 1979-80. If management had approved and implemented some of the cost-saving policies earlier, the department may not have had to suspend certain rehabilitation services in September 1980. Department officials point out that they implemented a number of other cost-saving measures earlier in 1980, but that these measures did not produce enough savings to meet the department's worsening financial condition.

Department officials stated they were reluctant to reduce spending levels or take significant action to reduce services because they expected that the Federal Government would augment grants as it had done in previous years. Department officials explained that, in previous years, the preliminary notices of federal grant amounts were usually lower than the grant amounts finally appropriated by Congress.

CONCLUSION

The Department of Rehabilitation experienced both reductions in its federal grants and increases in its salary costs during fiscal year 1980-81. In response, the department took several actions, including continuing a hiring freeze, restricting certain expenditures, and suspending most services to new clients.

As a result of the department's suspension of certain services, the department's waiting lists of eligible individuals grew and rehabilitation services to these individuals were delayed. The overall effect of this delay is uncertain. For example, some individuals may have been prevented from achieving program goals and others may have extended their dependence on public assistance. Yet some individuals who were denied services may have independently secured employment.

We found that the department suspended services because it predicted that it would run out of funds by mid-March 1981. This projection later turned out to be inaccurate because management did not estimate the effects of its cost-saving measures. As a result, instead of running out of funds, the department ended the year with $9.1 million in unspent funds.

Respectfully submitted,

Thomas W. Hayes

THOMAS W. HAYES
Auditor General

Date: December 30, 1981

Staff: Steven L. Schutte, Audit Manager
William S. Aldrich
Geraldine C. Parks, CPA

STATE OF CALIFORNIA—HEALTH AND WELFARE AGENCY

EDMUND G. BROWN JR., Governor

DEPARTMENT OF REHABILITATION
830 "K" STREET MALL
SACRAMENTO, CALIFORNIA 95814

December 29, 1981

Mr. Thomas W. Hayes
Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

Thank you for the opportunity to comment on your draft report entitled, "A Discussion of the Department of Rehabilitation Decision to Suspend Services to the Disabled During Fiscal Year 1980-81." We appreciate the courtesy and consideration shown to us by the auditors assigned to the study and your commitment to include our comments in the report when it is issued.

There are two major areas of the report which we believe need further clarification. We feel our comments will assist readers of the report in better understanding the action taken by the department in meeting the service and fiscal problems which it has faced over the past two fiscal years.

1. One of the major issues covered by the report (Page ii) is the question of "whether management had based its decision to suspend services upon accurate projections of the department's financial condition". The report concludes that the department's management, when it decided to suspend services in September 1980, "had not fully estimated the impact of its earlier actions to reduce costs" which were outlined in an August 7, 1980 directive to field offices.

   The August 7, 1980 directive, referenced as "earlier actions to reduce costs," (copy attached), had minimal affect on the ultimate reduction of case services costs achieved during FY 1980-81. The directive listed seven specific steps that should be taken to control costs. For the most part, these steps applied to the cost of new plans written by field staff after receipt of the directive, and would not affect the costs for those 42,000 clients in-plan as of August 1980.

   We therefore did not expect this seven step plan to have an immediate impact on cost reduction. This was born out by our end-of-September 1980 case services encumbrance report, which showed that September 1980 case services encumbrances had increased by 27% over the previous month ($13,660,000 to $17,288,000), compared to 28% for the same period in FY 1979-80 ($13,614,000 to $17,437,000).

   Since these data showed that encumbrances were following an historical pattern and it clearly would take several months for any new policies to begin to reverse this pattern, immediate steps had to be taken to reduce expenditures. As your report correctly points out (p. 13), if the department had continued to provide rehabilitation services to all clients, it would have exhausted all available funds by mid-March, 1981. It was to avoid this contingency that the temporary suspension of services to new clients was ordered in late September of 1980. Departmental management felt this alternative was far preferable to a total suspension of services in March that would have affected not only new applicants, but the 42,000 persons to whom it had already made a commitment for services.

The department's assessment of the impact of cost containment measures begun in August proved to be accurate. During the nine-month period (September 1980 through June 1981) only $1.3 million in case services savings can be attributed to the seven steps listed in the August Directive:

Type of Savings	Amount (in millions)
1. transportation	$0.19
2. maintenance	0.21
3. vehicle purchase	0.06
4. OJT	0.13
5. self-employment	0.00
6. post-graduate college	0.07
7. private schools	0.64
Total Savings	$1.30

These figures show that the department did estimate, with reasonable accuracy, the impact of its earlier actions to control costs at the time it decided to suspend services to new clients.

We do agree, however, that the department overestimated the cost of rehabilitation plans which were written during the second half of FY 1980-81 beginning January 1981 when service was resumed to new clients. During the period when services were suspended, the department developed new cost reduction policies to be put in effect in January 1981. The measures included: (a) having the department provide services itself whenever possible instead of purchasing services from private vendors; (b) placing limits on specified services such as length of time clients would remain in evaluation workshops; (c) creating job clubs for client placement; (d) substantial increases in the use of similar services and benefits provided by other agencies, such as increasing the use of Medi-Cal for medical diagnosis; and (e) paperwork reduction and other measures which served to decrease administrative costs.

The Legislative Analyst also reported that, during the spring of 1981, the department adopted these cost-saving policies in an effort to reduce the average cost of services provided to clients. (Please see attached letter, Page 3, from William G. Hamm, Legislative Analyst to Assemblyman Wadie P. Deddah, dated October 23, 1981.)

The reduction in rehabilitation costs in FY 1980-81 are largely attributable to measures implemented in January 1981, and not to those policies contained in the August 1980 directive. While these cost reduction measures were well into the planning stage in September 1980, it was not only difficult, but risky to forecast the savings which might begin three months later as a result of new policies never before implemented by the department. If such forecasts of untested cost savings methods were overestimated, it could have resulted in there being insufficient funds to maintain services to those 42,000 clients currently in-plan in August, 1980.

2. The other significant issue covered by the report is the conclusion on Page ii that "the department was slow in reacting to suspected financial problems because management was anticipating additional federal grants". On Page 16, the report states that "approximately five months lapsed between the time the department was aware of its potential financial problems and the time it implemented major policies aimed at reducing rehabilitation costs".

As far back as November 1979, the department became aware that uncertainties over federal funding would present problems for the State fiscal year beginning July 1, 1980. In addition, in January 1980, the department was aware of possible reductions associated with Proposition 9 on the June Ballot. The Governor's proposed pay increase of 9% for state employees was far from certain as it was highly dependent on the outcome of the Proposition 9 vote. This uncertainty made concrete planning impossible.

It should also be noted that the statement from the Department of Finance on Page 8 of your report indicating that the department had a responsibility "to obtain additional federal grants to cover the cost of salary increases..." overlooks the fact that vocational rehabilitation federal funds are granted to states on the basis of an allocation formula contained in the federal Rehabilitation Act. There are no additional federal funds available to cover salary increases.

Actions taken by the department in January 1980 to reduce salary and operating expenditures by continuing its hiring freeze appeared to cover the deficit of $6.9 million projected at that time for FY 1980-81. It was not until April 14, 1980, that we were notified of additional cuts of $5.9 million in SSI and OASDI funds available for rehabilitation. This cut, together with the defeat of Proposition 9 and the ultimate granting of a salary increase in July 1980, increased our projected deficit, requiring that additional cost reduction measures be taken.

On August 7, 1980, we issued the aforementioned directive to field offices as one step in a long-range plan for controlling costs. When a review of the case services encumbrance report for the first quarter of fiscal year 1980-81 indicated the necessity for further economies, the temporary suspension of services was implemented at the end of September to avoid jeopardizing services to existing clients.

The department then made plans for the adoption of other cost savings measures to meet its projected $13.4 million deficit. These measures turned out to be extremely effective. Five million dollars were saved in salary costs alone, by increasing our target for staff reductions. We had originally expected to abolish 137 positions, but a close review of administrative expenditures and staffing patterns accomplished by a departmental task force allowed us to raise this expectation to 407 positions without any sacrifice to quality of services. By July 1, 1981, 318 of these were vacated and abolished. The remaining 89 will be abolished by January 1, 1982.

We believe that the department reacted promptly and appropriately throughout calendar year 1980 as each change occurred to our financial planning estimates for FY 1980-81. We simply did not have the luxury of knowing in January 1980 that the cut in Federal Funds would nearly double by April 1980; that Proposition 9 would not pass in June 1980, thereby allowing a 9% increase in salary costs; or how long it would take for untested measures introduced in unprecedented circumstances to show a positive impact on our budget.

In summary, we agree with your basic conclusion that the unspent federal funds at the end of FY 1980-81 were due to our inability to fully assess the impact of cost reduction measures taken by us at various times during the year. These measures, which ultimately proved effective, were untried at the time they were implemented in January 1981. Although our goal was a cost reduction of at least $13.4 million in the vocational rehabilitation program, we ultimately achieved a savings of $23.4 million which enabled us to carry $10.0 million in federal funds into the 1981-82 state fiscal year. Without this carryover, the department would have had to implement substantial staff and program reductions on July 1, 1982 in view of further projected cuts in federal funds.

We believe that the ultimate outcomes of this experience were beneficial, in that we have developed new methods and resourcefulness that will allow us to deal with diminishing federal funding this fiscal year and next. Thank you again for the opportunity to comment on your report. If you need additional information, please call William McGauley at 2-6606.

Sincerely,

Edward V Roberts

EDWARD V. ROBERTS
Director

Attachments (2)

State of California

Memorandum

To : District Administrators

Date: August 7, 1980

File No.:

Telephone: ATSS (8) 485-9347
(916) 445-9347

From : Department of Rehabilitation
830 "K" Street Mall
Sacramento, California 95814

Subject: POLICIES TO BETTER CONTROL EXPENDITURES

ADMINISTRATIVE DIRECTIVE FOD 17-80-8

In order to more uniformly control expenditures statewide, the following policies are effective immediately:

1. Clients must use public transportation and discounts to the disabled when available and reasonable. (Although this has been the policy of the Department for some years, strict adherence has not been experienced.)

2. Maintenance will not be provided unless the client must live away from home. Emergency maintenance may be provided to a client who is released from a public institution or when a client's rehabilitation program is to be interrupted for an undertermined period of time and investigation reveals that the client has no other resources. Such emergency maintenance may be provided for a period of up to 60 days with the approval of the District Administrator.

3. All vehicles costing over $1,000 will require approval by the Assistant Deputy Director.

4. OJTs longer than three months or at a rate greater than a $700, $500, $300 decreasing rate require District Administrator approval.

5. Self-employment objectives will require approval by the District Administrator.

6. Vocational objectives for post graduate college education will require District Administrator approval.

7. Private schools will require prior approval by the Program Supervisor.

Bob Klein

ROBERT V. KLEIN, Deputy Director
Field Operations Division

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Joint Legislative Budget Committee

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LEGISLATIVE ANALYST
WILLIAM G. HAMM

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(916) 445-4656

October 23, 1981

Hon. Wadie P. Deddeh
Assemblyman, 80th District
Room 2013, State Capitol
Sacramento, California 95814

Dear Assemblyman Deddeh:

This is in response to your letter of October 1, 1981 requesting information about the Department of Rehabilitation's fiscal condition at the close of 1980-81 in order to respond to a constituent's inquiry. While we are unable to identify funding reductions specific to Mr. Farmer's service area in San Diego, we have attempted to outline how the department finished the year with a surplus and its effect on the department's programs.

Overview

State rehabilitation services are funded primarily by the federal government on an 80 percent federal/20 percent state matching basis. Thus, the department's budget is heavily influenced by funding decisions made at the national level. At the same time, federal financing traditionally gives the department more flexibility than state funds to carry over any savings from one state fiscal year to the next.

In order to understand the department's surplus, we describe (1) how estimates of federal funds available for expenditure in the state's 1980-81 fiscal year changed during the year, (2) what actions the department took to address a reduction of federal funds awards, and (3) what the availability of savings -- or carry-over -- in federal funds in 1980-81 means to the department's 1981-82 budget.

Our review shows that the department:

- Began the state 1980-81 fiscal year with a budget that overestimated the amount of federal rehabilitation funds it would receive during the federal fiscal year 1981.

- Reduced its 1980-81 estimate of federal expenditures in January 1981 (six months into the state fiscal year) to reflect the reduced federal funds actually awarded in federal fiscal year 1981. The revision indicated that the department anticipated spending less federal funds for rehabilitation services in 1980-81 than it had in 1979-80.

- Took a series of administrative steps throughout 1980-81 to reduce its federal expenditures and bring them in line with expected federal revenues. As a result of these steps, the department actually achieved a savings in expenditures rather than the deficit which it originally anticipated.

- Underestimated the savings that would accrue by June 1981 by over $8 million.

Federal Funds Anticipated in 1980-81 Were Overestimated

When the Legislature approved the department's 1980-81 budget in July 1980, it assumed that the department would have $96.7 million in federal funds for rehabilitation services. This amount was based on the department's reasonable expectation that federal funds would continue to increase as they had in past years.

By the fall of 1980, the department realized that federal funds would not increase as anticipated. Congress had not adopted a budget for federal fiscal year 1981, and funds were appropriated by a continuing resolution. Nationwide, the amounts available were less than what had been available during the last three fiscal years.

In January 1981, the department submitted its revised estimates of 1980-81 expenditures to the Legislature. The department reduced the federal funds budgeted for that year to take into account the lower level of funds appropriated by Congress. Table 1 compares the federal expenditures initially approved by the Legislature for 1980-81 with the department's revised January estimates.

Table 1

Department of Rehabilitation
Federal Funds
1980-81
(in millions)

Adopted Budget July 1980	Revised Estimate January 1981	Difference
$96.7	$92.0	$-4.7 (-4.9%)

Estimated 1980-81 Federal Expenditures Dropped Below 1979-80 Levels

As a result of Congressional action, federal rehabilitation funds did not increase as anticipated by the department. Equally important, the $92 million of federal funds estimated by the department for 1980-81 represented a net reduction of $3.2 million compared to the amount spent in 1979-80 for rehabilitation services. The department, therefore, had to adjust its program and reduce its expenditures to account for the reduction in federal funding.

Administrative Measures to Reduce Expenditures

In view of the reduction of funds, the department adopted three measures to reduce its expenditures throughout 1980-81.

1. Service Levels. During the fall of 1980, the department ordered a seven-week halt in services to new cases. Subsequently, it instituted service priorities which were in effect until January 1981 that gave preference for services to the severely disabled. By January, the department estimated that it would serve 17,000 new clients, a reduction of 14,000 cases, or 45.2 percent below what had been initially budgeted for 1980-81.

2. Service Costs. The department sought to reduce the average cost of services provided to clients. During the spring of 1981 it adopted several cost-saving policies including: (a) having the department provide services itself whenever possible, instead of purchasing the services from private vendors; (b) placing limits on specified services such as the length of time clients would remain in evaluation workshops; and (c) using similar services provided by other public agencies, such as increasing the use of Medi-Cal for medical diagnosis.

3. Administrative Costs. The department reduced its administrative expenditures by eliminating positions through attrition. By June 1981, it had used 127 fewer positions, or 5.8 percent less than estimated in January 1981. Position reductions also resulted in decreased costs for operating expenses and equipment.

Savings Were Underestimated

Based on testimony presented during budget hearings in the spring of 1981, it was the Legislature's understanding that the reductions in services and administration would allow the department to finish the 1980-81 fiscal year in a solvent position. In May, the department informed the fiscal committees that its actions not only reduced expenditures, but would result in a $2 million savings that would be available in 1981-82. The actual expenditure figures for 1980-81, however, show that the department underestimated the savings resulting from its cutbacks in service by approximately $8 million.

Table 2 compares the Department of Rehabilitation's estimated and actual expenditures for 1980-81 by spending component, funding source, and number of positions.

Table 2

Comparison of Estimated and Actual Expenditures and Revenues (All Funds)
Department of Rehabilitation
1980-81
(in millions)

	Estimated	Actual	Difference (Savings)
Expenditures			
Personal Services	$ 55.9	$ 55.6	$ -0.3
Operating Expenses	49.9	47.4	-2.5
Case Services	36.7	29.2	-7.5
Totals	$142.5	$132.2	$-10.3
Funding Source			
General Fund	($ 19.0)	($ 19.2)	($ 0.2)
Federal Funds	(92.0)	(81.2)	(-10.8)
Vending Stand Fees	(1.2)	(1.1)	(-0.1)
Reimbursements	(30.3)	(30.7)	(0.4)
Totals	($142.5)	($132.2)	($-10.3)
Positions	2,173.7	2,046.8	-126.9

The biggest savings, $7.5 million, is in case services dollars. According to the department, this is the result of three factors:

- The number of new referrals did not grow as anticipated during the last six months of the 1980-81 fiscal year,

- The average cost per case was reduced as a result of new departmental policies, and

- A large number of cases which were considered not likely to be rehabilitated were closed out, thereby freeing up case services dollars.

Reductions in operating expenses resulted in additional savings of $2.4 million distributed throughout most line item categories, including contracts and consultants. The department considers these savings to be a natural by-product of less staff and administrative cost reductions.

Finally, the department used 127 fewer positions, or 5.8 percent less than initially estimated. Resulting salary savings, however, were used to absorb 1980-81 cost-of-living salary adjustments and the one-time retroactive pay award granted to all state employees by the court in December 1980. Therefore, the reduction in positions allowed the department to finish the fiscal year within $300,000 of its estimated budget for personal services.

Unexpected Savings in the Department's 1981-82 Budget

The Legislature approved the 1981-82 budget of $139.4 million (all funds) with the understanding that $2 million would come from 1980-81 federal funds savings (or carry-over). The department advised the fiscal committees that the carry-over would be used to offset an anticipated $4 million reduction in federal funds in federal fiscal year 1982. The final 1981-82 budget also made further administrative reductions and redirected funds to provide direct services to more clients.

The effect of the unexpected carry-over from 1980-81 (totaling $10.3 million) is to give the department an opportunity to operate at a different program level than approved by the Legislature for 1981-82. In June, the Legislature approved a 1981-82 budget that was expected to be a reduction of $3.1 million compared to 1980-81. Due to the carry-over of savings from the 1980-81 fiscal year, however, the 1981-82 budget actually represents an increase of $7.2 million over 1980-81 expenditures.

Because President Reagan's budget is not yet finalized, we do not know if the department's projections of federal fiscal year 1982 federal funds incorporated in the 1981-82 budget will materialize. Our analysis of the Omnibus Reconciliation Act shows that the department may lose from $3 million to $11 million in federal funds in 1981-82. The carry-over will be used to offset this loss. If the loss is less than $10.3 million, however, the department will, in fact, be able to increase its expenditure levels beyond what was approved in the 1981-82 budget.

Conclusion

We share Mr. Farmer's concern that the department manage its state and federal funds in a manner which ensures delivery of necessary services to clients. We will continue to monitor the department's expenditures and client services in order to advise the Legislature during the 1982-83 budget hearings of the department's performance.

If you have any further questions, please contact Elizabeth Hill or Julia Lopez of my staff at 322-8406.

Sincerely,

for William G. Hamm
Legislative Analyst

COMPARISON OF PROJECTED AMOUNTS WHEN CASE SERVICES WERE SUSPENDED WITH ACTUAL AMOUNTS AT JUNE 30, 1981
(In Millions)

	Amounts Projected	Actual Amounts at June 30, 1981[a]	Difference
Available Funds:			
1980-81 Federal Grants	$ 82.6	$ 82.5	$(0.1)
Carryovers[b]	7.8	9.5	1.7
State General Fund[c] Appropriations	18.1	19.1	1.0
Total Available	$108.5	$111.1	$ 2.6
Expenditures:			
Salaries	$ 53.1	$ 52.7	$ 0.4
Case Services	34.2	26.0	8.2
Other Operating Expenses	24.0	23.3	0.7
Total Expenditures	$111.3	$102.0	$ 9.3
Unexpended Balance (Shortage)	$ (2.8)	$ 9.1	$11.9

a Because the projections of available funds excluded reimbursements and reimbursed expenditures, we have adjusted the actual year-end figures accordingly. Actual reimbursed expenditures during fiscal year 1980-81 totaled $30.7 million, consisting of approximately $26.4 million for the Work Activity Program, $1.2 million for case services, $2.3 million for other personal services, and $0.8 million for other operating expenses.

b Carryovers are unspent amounts from grants from previous years.

c These include only General Fund appropriations specified by Chapter 510, Items 308 and 308.1 of the Budget Act of 1981.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
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