California State Auditor

BUREAU OF STATE AUDITS

California Department of Corrections:

Its Fiscal Practices and Internal Controls Are Inadequate to Ensure Fiscal Responsibility

CALIFORNIA STATE AUDITOR
BUREAU OF STATE AUDITS

November 2001
2001-108

The first five copies of each California State Auditor report are free.
Additional copies are $3 each, payable by check or money order.
You can obtain reports by contacting the Bureau of State Audits
at the following address:

California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
(916) 445-0255 or TDD (916) 445-0255 x 216

OR

This report may also be available
on the World Wide Web
http://www.bsa.ca.gov/bsa/

The California State Auditor is pleased to announce
the availability of an online subscription service.
For information on how to subscribe,
please visit our Web site at www.bsa.ca.gov/bsa.
If you need additional information, please contact
David Madrigal at (916) 445-0255, ext. 201.

Alternate format reports available upon request.

CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

November 27, 2001

2001-108

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the fiscal practices and internal controls of the California Department of Corrections (department).

This report concludes that the department's fiscal practices and internal controls are inadequate to protect the best interests of the State. Its poor fiscal practices may have contributed to the significant budget shortfalls that the department has incurred over the past four years. Specifically, the department utilizes inaccurate spending plans, has not updated its budgeted cost formulas, does not always take corrective action for identified problems, and does not always conduct sound fiscal analyses. Even so, the primary causes of its budget shortfalls are custody staff compensation and inmate medical expenses. Excessive overtime expenditures resulting from numerous custody staff vacancies and overuse of sick leave, combined with an inadequate budget, create most of the shortfall.

The department can also improve its contracting and cost control practices. For example, the department could save the State hundreds of thousands of dollars per year by expanding one of its job placement programs and eliminating another. In addition, the department has failed to ensure that its subcontractors are paid promptly and does not utilize its contractor monitoring resources effectively. Moreover, while the department has reduced some of its administrative costs, it exaggerated the extent to which a reorganization resulted in certain cost reductions. Much of this reported cost savings is the result of normal year-end budget activities. Finally, while the department has made some progress in developing strategies to reduce legal costs and actions against the department, it has not fully implemented its plans.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

BUREAU OF STATE AUDITS
555 Capitol Mall, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019 www.bsa.ca.gov/bsa

CONTENTS

SUMMARY

RESULTS IN BRIEF

Audit Highlights . . .

Our review of the California Department of Corrections' (department) fiscal practices and internal controls revealed:

- ☑ ***Spending plans, which are used to control program expenditures and to identify potential shortfalls, are inaccurate and do not align with the department's spending authority.***
- ☑ ***Excessive use of custody staff overtime and sick leave, combined with inadequate funding, is the primary cause of its budget shortfalls.***
- ☑ ***Improved contracting practices could result in hundreds of thousands of dollars per year in savings and prompt payments to contractors.***
- ☑ ***Proactive strategies for reducing costs related to legal actions are not fully implemented.***

The fiscal practices and internal controls of the California Department of Corrections (department) are inadequate to ensure effective fiscal management and to protect the best interests of the State of California (State). Over the past four years, the department has experienced budget shortfalls that made funding augmentations of between $20 million and $200 million necessary for the department to satisfy its financial obligations. The department's poor fiscal management may have contributed to these shortfalls. Specifically, department spending plans, used to control program expenditures and to identify potential shortfalls, fail to align with the department's spending authority—having variances as large as $168 million.[1] When the department's spending plans do not agree with its spending authority, the department is either over- or underrepresenting to its various programs and institutions the amount of funds available. Consequently, the programs and institutions may inadvertently overspend the department's spending authority or believe that they have overspent when, in fact, they have not. This lack of alignment also hinders the department's fiscal management because the department's monthly budget reviews (the department's primary fiscal management system) base their decision making on these invalid spending plan figures.

Even when its fiscal management system identifies an area of potential concern, the department rarely takes corrective action. To its credit, the department does conduct two additional types of fiscal reviews designed to identify and address fiscal and operational problems; however, these reviews are too infrequent to serve as adequate replacements for its primary fiscal management system. Until the department uses valid information and acts to correct identified problems, its fiscal management efforts are futile.

Our analysis of the department's $197 million budget shortfall for fiscal year 2000–01 revealed that the primary cause for the shortfall was custody staff compensation, which accounted for approximately $147 million of the shortfall. About $87 million

[1] Spending authority is the department's legislatively approved budget, including amounts approved in the budget act and through subsequent finance letters and budget change proposals.

of that portion related to excessive overtime for custody staff required to make up for numerous vacant positions and exorbitant use of sick leave. The department could save the State about $42 million in overtime costs by filling roughly 1,500 of its 2,300 vacant custody positions. According to the department, filling these vacancies should also help its institutions cope with the increase of violence it has experienced in recent years.

The department could achieve further savings by reducing the custody staff's use of sick leave. In fiscal year 2000–01, custody staff used nearly 2.3 million hours of sick leave, an amount that is more than 64 percent higher than the department's budgeted level of 1.4 million hours. If the department lowered its current use of sick leave to the budgeted level, the department would need to fill 505 fewer custody positions of the 1,500 we mentioned earlier. This action would allow the department to avoid costly overtime and assist in balancing its custody staff budget. However, the department has not succeeded in achieving reductions in this area. Also contributing to the department's budget shortfall are escalating workers' compensation costs, which the department has not yet mitigated.

Other factors probably contributed to the department's shortfalls. However, our analysis was hampered primarily because the department could not provide adequate support for how it used budget augmentations. Consequently, we could not always determine the specific expenditures that exceeded the department's original spending plan and that created the shortfall. Nevertheless, most of the department's remaining budget shortfall appears related to significant increases in the costs of pharmacy contracts and medical services for inmates.

Moreover, we found that the department does not receive adequate funding relative to its actual costs for custody staff. Specifically, department expenditures for each filled position exceeded funding levels by $4,300 to $8,400 per year, depending on staffing levels. Nevertheless, the department's funding shortfalls in fiscal year 2000–01 appear to have been resolved by funding augmentations the Legislature approved during that period. However, as previously mentioned, the department's spending authority does not correspond to the department's spending. To clarify its fiscal condition and spending practices, the department should prepare and periodically report its spending plan and the results of its operations to the Legislature.

Ultimately, this information should allow for a realignment of the department's spending authority to match its needs appropriately.

The department also has weak contracting practices that fail to protect the best interests of not only the department's subcontractors but also the State. For example, the department could save hundreds of thousands of dollars per year and place hundreds of additional parolees into the workforce by expanding its use of the Jobs Plus Program (Jobs Plus) and eliminating the Offender Employment Continuum Program (Continuum). Although these contracted programs offer similar services, Continuum costs the department $824 more per job placement and has a much lower job placement rate than does Jobs Plus. Had the department used Jobs Plus rather than Continuum for the 869 job placements that Continuum made in fiscal year 2000–01, it would have saved $716,360—funds the department could have used to offset shortfalls in other areas. In addition, had all the parolees referred to Continuum been referred to Jobs Plus, as many as 534 additional parolees could have been placed in the workforce.

The department has also spent too much for contract administration. For example, it paid $23,989 more than it should have to the Jobs Plus contract administrator during fiscal year 2000–01. In addition, the department could save even more in future Jobs Plus contracts by negotiating the contract administration cost rate used for federal programs. Had the department negotiated the federal rate in place at the time the department agreed to the current contract, it could have saved more than $230,000 in fiscal year 2000–01.

Moreover, the department is not ensuring that subcontractors providing substance abuse treatment services to parolees receive prompt payment. Some subcontractors have had to wait as long as four months to receive payment. Such lengthy delays can have severe repercussions for subcontractors, most of which are nonprofit, forcing some to rely on costly lines of credit to meet their financial obligations and threatening the solvency of others.

We also found that the department's monitoring of subcontractors is inconsistent—inadequate in some cases and excessive in others. In some cases, the department relies exclusively on primary contractors to perform invoice and site reviews on subcontractors even when contractor and subcontractor are the same entity. Inconsistent contract monitoring has prevented the department from allocating its limited resources in the most efficient, effective manner to ensure the accuracy of contractor invoices and the satisfactory delivery of services.

Although the department has reduced some of its costs, it has exaggerated the extent to which a reorganization has resulted in certain cost reductions. In an April 2001 hearing before the Joint Legislative Audit Committee, the department's chief financial officer reported that a reorganization of the department's Central Administration Division resulted in cost reductions of $19.6 million in fiscal year 2000–01. However, our analysis revealed that $13.6 million of the reported savings related to what we consider normal year-end budget activities rather than to reorganization.

Finally, although the department has made progress recently in developing and implementing strategies designed to reduce the occurrence and consequences of costly legal action against the department, it has not fully implemented its plans. Until the department fully executes all its cost-cutting strategies, it will not be able to control legal claims and costs as effectively as possible.

RECOMMENDATIONS

To ensure that it manages state funds responsibly, the department should take the following steps:

- Align its spending plan with its total spending authority.
- Make certain that divisions prepare and implement corrective action plans to resolve projected funding shortfalls.
- Move aggressively to fill all vacant custody staff positions.
- Continue pursuing means to lower to budgeted levels its staff's sick leave use.
- Contract with job placement programs that place more parolees in jobs at a lower cost per placement than does the Continuum.
- Seek repayment from the job placement contractor that it has overpaid.
- Negotiate administration cost rates in future contracts that are equal to or better than those allowed by federal programs.

- Ensure that all subcontractors are paid promptly.
- Fully implement all its strategies to reduce legal costs as soon as possible.

AGENCY COMMENTS

The department generally concurs with the report findings and recommendations and states that it will work diligently to implement strategies to improve fiscal, contracting, legal, personnel management, and business practices. However, the department also stated that it has inadequate staff resources to conduct the operational reporting to the Legislature that we recommend. ■

Blank page inserted for reproduction purposes only.

INTRODUCTION

BACKGROUND

As the agency responsible for overseeing and managing California's 33 prisons (institutions), the California Department of Corrections (department) operates the largest prison system in the United States. For fiscal year 2001–02, the department projected that it would need 46,548 employees to fulfill its responsibilities. The department's mission is to control, care for, and treat men and women who are convicted of serious crimes or admitted to the State's civil narcotics program and who are then placed in the department's Institution, Health Care Services, or Community Correctional programs.

The department is organized into four programs: Central Administration, Health Care Services, Community Correctional (Paroles), and Institution. Through the Institution Program, the department provides prison inmates with safe, secure detention facilities and necessary services, such as food, clothing, and medical care. As Figure 1 on the following page illustrates, costs for this program alone represent $3.5 billion, or roughly 73 percent, of the $4.8 billion that is the department's total approved budget from all funding sources for fiscal year 2001–02.

What Is the Difference Between Spending Authority and Spending Plan?

Spending authority is the department's authorized funding approved by the Legislature and governor via the budget act and by subsequent executive orders.

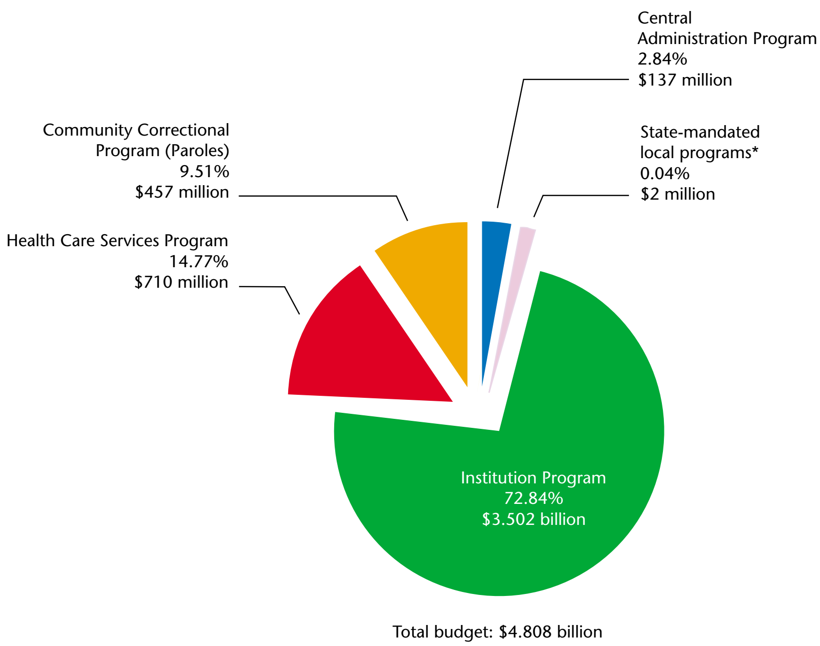
The department designed its **spending plan** to be a detailed breakdown (to line-item detail, such as projected expenditures for clothing, electricity, and overtime) of total department spending authority for individual programs and institutions.

THE DEPARTMENT'S BUDGETARY PROCESS IS COMPLEX

The department has essentially two budgeting processes: one to obtain its spending authority and one intended to provide a detailed spending plan for distributing the department's total spending authority to its divisions and institutions. The department works closely with the Department of Finance (Finance) in building its component of the governor's budget—the governor's recommendations for and estimated costs of state operations in the next fiscal year. The governor's budget is submitted to the Legislature for modification and approval, but ultimately the governor can reduce or veto legislatively approved spending before the enactment of the budget (budget act). Through this process, the department and other state entities obtain their spending authority.

FIGURE 1

Budget Allocations for the Department of Corrections
Fiscal Year 2001–02



* State reimbursements to local governments for the cost of activities required by legislative and executive acts.

Like all government agencies, the department has a responsibility to ensure that taxpayer funds are spent appropriately and in accordance with the public's mandate and interests. Therefore, good budgeting and control practices are imperative not only to maintain a balance between demands for services and projects and the resources drawn from the public but also to help policy makers set goals, assist program managers and department heads in improving organizational performance, and make state officials accountable to the public.

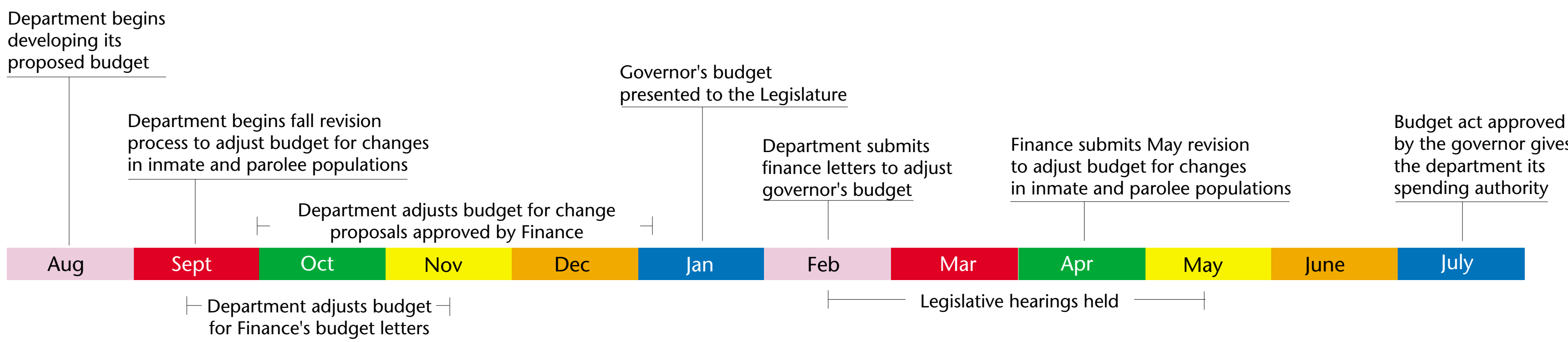
The department's budget process begins approximately one year before the budget act becomes law. The department begins with its final approved spending authority from the previous year's budget act and adjusts it for budget letters (budget policies and instructions issued by Finance) and one-time costs from the previous year (nonrecurring expenditures not intended to be included in the budget for subsequent years). California's budget process requires the department to submit requests for additional funding through mechanisms called budget change proposals.

Budget change proposals comprise current- and budget-year portions. The budget-year component is a request for additional funding for the upcoming budget year and the approved amount is built into the governor's budget for that particular year. The current-year component provides additional funding during the current budget year. For example, for a fiscal year 2001–02 budget change proposal, the current-year component would be for funding related to fiscal year 2000–01 (the year in which the budget for the following year is being prepared). The current-year component is often a portion of the department's deficit funding (a requested augmentation during a fiscal year to cover a shortfall in funding for projected expenditures). Figure 2 on the following page shows the major processes that affect the department's approved spending authority as granted through the passage of the annual budget act, including two budget change proposals for inmate and parolee populations. Specifically, the fall population adjustment and the May revision adjust the department's spending authority and authorized staffing for increases or decreases in inmate and parolee populations.

The department begins developing its spending plan shortly before the fiscal year begins. The department uses the spending plan to distribute its spending authority to programs and regional accounting offices, which receive the funding for the institutions in their regions. The department separates its detailed spending plan into two major categories of expenses: personal services (salaries and wages, overtime, temporary help, and benefits) and operating expenses and equipment (including general expense, utilities, facilities operations, and other expenses). In most cases, the department bases its initial spending plan on figures from the previous year's spending plan. The department usually issues the initial spending plan schedules to individual programs and institutions around the end of July or early August, after passage of the budget act. The department makes other changes to the initial spending plan throughout the year. The department refers to these changes as budget changes; however, we refer to them as spending plan changes. The department's first spending plan change updates the salary and wage component of its spending plan to make it current with the authorized positions presented in the governor's budget. Other spending plan changes account for budget change proposals, actual expenditures for some categories, and other items that may affect the budget.

FIGURE 2

The Department of Corrections' Budget Process



As in the department's spending authority process, the size of institutions' populations is a factor in establishing the department's spending plan. However, while the department adjusts its spending authority for changes in inmate and parolee populations twice a year—in the fall and May population budget change proposals (see Figure 2)—the department adjusts its spending plan for population fluctuations every time a spending plan change occurs. For the institutions' spending plans, this change can occur four or more times in a fiscal year.

Additionally, the department has the ability to move its funds among line items within a particular program. Thus, although the department develops its spending plans as a guide for its programs, including the Institution Program, it can use funds from other line items to cover shortfalls in problem areas. The department also has the ability to move as much as 5 percent of a program's spending authority to another program with approval from Finance.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct a comprehensive audit of the department's budget practices and fiscal management. The audit committee expressed particular concern regarding the department's budget deficiencies and the growth in its Central Administration Program over the past four years. Our review focused on the Institution and Central Administration programs, which constitute the majority of the department's total expenditures and spending authority.

Throughout our work, we reviewed documents prepared by the department, policies and procedures, and applicable laws, and we interviewed department staff. To review and assess the department's process for developing its budget and requests for additional funds, we analyzed budget and expenditure data for fiscal years 1997–98 through 2000–01. We could not fully assess the adequacy of the department's budget process and causes of deficiencies because, in many cases, the department could not provide adequate support. In addition, we could not fully evaluate the department's base budgeting methodologies because the department could not provide sufficient support showing how some of its budget was originally developed.

To determine what expenditure types account for the most significant portions of budget shortfalls, we reviewed expenditure data and payroll and leave records.

To evaluate the extent of the director's discretion over spending, we examined documents prepared by the department as well as policies and procedures, and we interviewed department staff. We found that the director has almost unlimited discretion over department spending within its programs. As with the governor and all department directors, the discretion lies within such constraints as court orders, logistical realities, and health and safety issues.

To identify the reason for increases in the expenditures of the department's Facilities and Business Management Division (formerly the Planning and Construction Division), we discussed reasons for increases with various division staff and reviewed supporting documentation. The division's total expenditures increased from $37 million in fiscal year 1997–98 to approximately $118 million in fiscal year 2000–01. Further, the department's total budgetary authority for capital outlay increased from more than $5 million in fiscal year 1997–98 to more than $98 million in fiscal year 2000–01 to allow for various repairs, upgrades, and construction of new facilities at existing institutions. The significant increase in expenditures is due primarily to the design and construction of a new institution, approved in July 1999, and its continuing need to repair and expand its aging facilities. In addition, the division absorbed the functions of business services, contract management, and preventative maintenance in August 2000.

To determine the cause of significant increases in the salaries related to staff in the Executive Division and Regional Accounting offices, we interviewed department staff and reviewed planning and budgetary documents. We found that 82 percent of the increases in these two areas were caused by the increase in the number of filled positions related to the Central Administration Program's new and expanded divisions that the Legislature had approved.

To assess the department's contracting and monitoring practices, we analyzed a sample of contract files and responses to bid requests, and we interviewed division staff. We also reviewed a sample of contractor and subcontractor invoices.

To evaluate whether the reorganization and management practices are affecting operations as projected and reported to the Legislature, we looked at documents related to the department's preparation for the reorganization, including proposed and actual cost savings. We also reviewed data on vacant positions that existed both before and after the reorganization to determine whether the proposed position cuts actually occurred.

To determine whether the department is taking appropriate action to reduce its legal expenses, we reviewed expenditure data and other available evidence of proposed or past actions, and we interviewed legal staff. ■

Blank page inserted for reproduction purposes only.

CHAPTER 1

Poor Fiscal Management and Budget Shortfalls Plague the Department

CHAPTER SUMMARY

Weak fiscal practices at the California Department of Corrections (department) prevent the department from managing its budget and expenditures effectively. During the past four years, the department incurred budget shortfalls, and it requested and received annual funding augmentations ranging from $20 million to $200 million so that it could satisfy its financial obligations. The department's poor fiscal management may have contributed to these shortfalls. Specifically, the department's spending plans, which help the department control program expenditures and identify potential shortfalls, do not provide an accurate base from which the department can make informed fiscal decisions. This situation arose from the department's failure to follow a basic principle of sound financial management—ensuring that spending plans align with available spending authority—until we brought this principle to the department's attention.

During its monthly budget plan reviews (monthly reviews), the department bases its decision making on these inaccurate spending plans, and this practice further hampers the department's ability to practice sound fiscal management. Moreover, the department rarely takes corrective action even when the monthly reviews identify areas of concern. To its credit, the department conducts two other types of reviews designed to identify and address fiscal and operational problems. However, the department has only conducted these reviews annually, and this schedule, in light of the department's recurring problems with overspending, seems inadequate. Until the department conducts its monthly reviews using valid information and then acts to correct identified problems, it cannot ensure that it is protecting the best interests of the State.

Most of the department's funding shortfall in fiscal year 2000–01 related to compensation for custody staff.[2] The primary cause for this portion of the shortfall was the exorbitant amount of overtime worked by custody staff because numerous custody positions had vacancies and because staff used sick leave excessively. The department could save the State millions in overtime costs by filling its custody staff vacancies and by reducing the excessive use of overtime and sick leave. If the department reduced the current level of sick-leave use to budgeted amounts, the department could both prevent costly overtime by current employees and avoid hiring new employees to cover the jobs of absent staff. However, the department has not yet achieved reductions in this area. Escalating workers' compensation costs also contributed to the department's budget shortfall. Despite recent reductions in its overall funding for workers' compensation, the department has failed to manage these costs effectively. Further, we found that the department does not receive adequate funding for filled custody positions relative to the actual cost of custody staff salaries.

Other factors probably contributed to the department's shortfalls. However, our analysis could not identify these conditions because the department could not provide adequate support for its application of budget augmentations to its spending plans. Nevertheless, we were able to determine that after custody staff compensation, the second most significant factor contributing to the department's budget shortfall was significant increases in the costs of pharmacy contracts and medical services. Finally, we found that although its operating expenditures and equipment costs escalated in some areas, the department's spending plans indicate that its total operating funds were sufficient to cover the increases.

Recent augmentations should prevent a shortfall in the department's budget for fiscal year 2001–02. However, it is unclear what effect recent directives from the Department of Finance (Finance) and executive orders will have on the department's budget. Nevertheless, to provide a realistic picture of its fiscal condition and how it spends its funds, the department should periodically report the results of its operations to the Legislature. This report should cover the department's spending plan, which should align with the

[2] In this report, *custody staff* refers to correctional officers, sergeants, and lieutenants who guard and care for inmates in institutions.

department's spending authority, as well as actual expenditures and realistic projections of how the department expects to spend its remaining allocations. Given this information, the Legislature should be able to ensure that the department's spending authority reflects the department's needs.

THE DEPARTMENT FOLLOWS POOR FISCAL PRACTICES

Although the department has recently attempted to better control and analyze its fiscal affairs, significant room for improvement remains. Resolving ineffective practices that result in inaccurate spending plans and other poor controls would allow the department to conduct the meaningful fiscal analysis needed to identify and accurately portray areas of concern and to take appropriate action toward resolution.

Unrealistic Spending Plans Hinder the Department's Ability to Manage Its Fiscal Situation Effectively

The department's spending plans, which it uses to control program expenditures and to identify potential shortfalls, do not provide an accurate base from which it can make informed fiscal decisions. This situation has occurred because the department failed to ensure that its spending plans correspond to its spending authority. This failure may have contributed to the department's past funding shortfalls.

In each of the past four years, the department received between \$20 million and \$147 million in funding augmentations for contingencies and emergencies. As of October 2001 the department was also waiting for final approval of another \$52.5 million augmentation to the 2000–01 budget—bringing total requested funding augmentations for this year to more than \$200 million. In some cases, as Table 1 on the following page indicates, the Legislature has granted augmentations to cover the costs associated with newly created programs or increases in the population of inmates. However, in other cases, these augmentations resulted from the department's inability to keep expenditures within the spending authority that the Legislature had approved.

TABLE 1

The Department Received Funding Augmentations for Various Contingencies and Emergencies (In Thousands)

Reason for Augmentation	Fiscal Year 1997–98	1998–99	1999–2000	2000–01
Population adjustments	$17,784	—	—	$ 28,635
Salaries, wages, and benefits	3,884	$ 31,126	$ 1,532	28,736
Underbudgeted leave	—	—	4,126	—
Staffing increases	—	982	1,625	—
New program costs	6,229	1,235	10,028	—
Litigation costs	2,308	—	—	—
Inmate health care	5,967	2,046	1,887	48,731
Utilities	—	—	—	29,118
Unidentified budget shortfall	—	70,807	—	52,506*
Other	—	193	1,511	12,498
Total deficit funding received	**$36,172**	**$106,389**	**$20,709**	**$200,224**

* Pending legislative approval.

The department's spending authority and spending plan do not rely on the same figures. The department bases its annual spending authority request for the coming fiscal year on the previous year's final budget numbers. The department receives official notification of its spending authority at the beginning of each fiscal year when the governor signs the budget act into law. At about the same time, the department designs its spending plan to show the individual programs' and institutions' shares of the department's spending authority in line-item detail.[3] Rather than use its spending authority as the basis for its spending plans, however, the department uses the last budget change to the previous year's spending plan. The differences in the starting points for the two processes result in differences that may compound over a period of years if no attempt is made to align them on a regular basis.

[3] Line items in the spending plan include details against which the department can charge expenditures. Overtime for emergencies, clothing, and utilities are examples of line items.

Oddly, we found that the department did not have a process for reconciling the differences between its spending authority and spending plans. According to the department's Institution and Community Correctional Program budgeting managers, the budget staff was not aware that they needed to align their spending plan figures with the department's legally approved spending authority. This is analogous to a family establishing a spending plan that does not correspond to its income. While this situation may not be uncommon for families, it is improper for a state agency.

As illustrated in Table 2, large differences exist between the department's year-end spending plan and its spending authority.

TABLE 2

The Department's Spending Plans Do Not Align With Its Spending Authority

	1997–98	1998–99	1999–2000	2000–01
Final spending plan*	$3,616,994,209	$3,558,997,825	$3,903,242,639	$4,249,665,874
Final spending authority*	3,448,188,331	3,655,198,474	3,851,880,465	4,249,665,874
Difference	**$ 168,805,878**	**$ (96,200,649)**	**$ 51,362,174**	**$ 0†**

* All figures shown are for the State's General Fund (general support only) and include funding augmentations.

† To reconcile these figures for fiscal year 2000–01 the department removed $30 million from its spending plan at year-end.

Because the department reportedly compares its expenditures to its spending plans to determine where its budget surpluses and deficits exist, this difference can cause the department to believe it has more or less money to spend than it actually does. By overstating its spending plans, the department gives its divisions and institutions the impression that they have more available funds than they do. If informed they have a certain amount of funds available, the department's divisions and institutions will likely spend all of those funds, unknowingly causing the department to be in a deficiency situation. Conversely, understating spending plan amounts can cause the department to believe it has overspent and to request deficiency funding, when in reality, funds are available.

In fact, the department reverted millions of dollars in funding in two of the years we analyzed.[4,5] The department actually returned to the General Fund total unused spending authority of $22 million and $53 million in fiscal years 1997–98 and 1998–99, respectively. Although approximately half of the fiscal year 1998–99 reversion amount was related to restricted funding the department could not spend because its inmate populations were not as large as expected, the remainder may be attributed to the department's failure to align its spending plans and spending authority. The department may have also overstated encumbrances that it expected to be attributable to those fiscal years and ordered items it found that it did not need and thus had to disencumber.[6,7] The department's chief financial officer attributes its ability to return monies to the General Fund to "belt tightening measures" that enabled it to spend less than it originally projected. While this explanation may have some merit, she also agreed that ensuring its spending plans align with its available funding authority is a basic principle of sound financial management. However, as noted above, the department did not have a policy for doing so.

It is not surprising that programs overspent because their spending plans did not align with their spending authority.

After we brought this issue to its attention, the department finally attempted to align its spending authority to its spending plan for fiscal year 2000–01, though it did not complete this effort until more than two months after the June 30 fiscal year-end. As Table 2 on page 19 indicates, its reconciliation brought the two figures into alignment; however, according to one of its regional administrators, the department ultimately had to cut approximately $30 million from its final spending plan for the plan to correspond with its year-end spending authority (Table 2 reflects the spending plan after this reduction). Because the spending plan communicated to program managers during the year was not the same as the department's spending authority, it is not surprising that programs overspent. Although the department's effort to finally align its spending plan with its spending authority is a positive step, the department needs to perform this exercise throughout the year to ensure that it has a clear understanding of its true fiscal situation and can make sound fiscal decisions.

[4] State agencies, such as the department, have three years (the actual budget year plus two consecutive subsequent years) to use its General Fund spending authority for accrued expenditures and earmarked obligations related to that particular fiscal year. At the end of this three-year period, state agencies must return any unused funds to the General Fund.

[5] Reversion figures for fiscal years 1999–2000 and 2000–01 are not yet available.

[6] *Encumbrances* are funds earmarked to pay for goods or services not yet received.

[7] *Disencumbrances* is removing an earmark on funds set aside to pay for goods or services not yet received.

The department's unrealistic spending plans present a larger problem than the obvious disconnect caused by over- or underrepresenting what the institutions and programs have to spend. As discussed later in this chapter, the department's existing monitoring mechanisms rely on spending plans to show projected deficit and surplus amounts and to alert the department to potential and recurring fiscal problems within individual institutions throughout the year. Therefore, its use of inaccurate spending plan numbers hinders the department's ability to accurately identify and address potential problem areas.

The Department Needs to Reevaluate Its Standard Costs

To adjust the department's spending authority and spending plans for increases and decreases in inmate and parolee populations and in the number of staff needed to guard and to provide services to inmates, the department uses standard cost factors. However, we found that the department did not update these standard costs as recommended by the department staff that redesigned them.

The department's Standard Cost Project Manual outlines the standard costs related to certain operating expense and equipment line items considered either inmate- or staff-driven. For example, the department's method adjusts for an increase in the number of inmates by increasing the department's costs for items such as clothing, food, and waste removal. In addition, an increase in the number of inmates can drive the need for new custody staff. In fact, the department receives authority for one new position for every six new inmates admitted to one of its institutions that exceed the institution's designed inmate capacity.[8] These standards were revised by department staff in response to supplemental budget act language in fiscal year 1997–98, and the department began using the new standards beginning in fiscal year 1999–2000.

The standard cost factors used to determine the department's budget for inmate and staff operating expenditures are outdated and do not reflect the department's true needs.

However, the department has not revised these standards, despite recommendations from staff that the department update many of the standards annually. Consequently, the information used to compile the standards are now over four years old and do not reflect the department's true needs. For example, our comparison of the Institution Program's spending plan to its actual expenditures for fiscal year 2000–01 reveals a spending plan excess of over $51 million for the department's standard costs related to the

[8] This position can be a custody or non-custody position, such as that of office assistant.

number of inmates under its care and an excess of almost $24 million for staff-driven operating expenditures and equipment. When other operating expenditure and equipment items are included, the spending plan indicates that it had a total surplus of over $37 million for fiscal year 2000–01.

These disparities appear to be related to how the department developed the standard costs, using three-year actual expenditure averages for operating expenses and equipment—even when the costs were declining. Using an average for a cost that is declining can result in an amount that is higher than the actual cost. Given the complexity of the department's budget and the significant fluctuations in prior-year costs, the department's interests would be best served by using trends rather than averages over a longer period, such as five years. This should allow for a cost factor that would more closely represent the department's true costs. In any event, the department should update these figures more frequently as recommended by its staff.

The Department's Fiscal Monitoring Activities Are Inadequate

The department needs to improve its primary fiscal management system to ensure that it uses a reasonable basis for decision making and for taking prompt corrective action when it identifies problems. Until it does so, its fiscal management efforts are futile.

Until the department ensures that its spending plan figures agree with its spending authority, fiscal management efforts will be futile.

The department uses the monthly budget plan review as its primary fiscal management system to monitor and control its fiscal situation and ensure accountability. Historically, this system has been used only by the department's Institution and Health Care Services programs; however, the department expanded the system for department-wide use in late August 2001. The department designed these monthly reviews to quickly alert institution and Central Administration managers of potential deficits. To achieve this, the monthly reviews compare each institution's spending plan figures for individual items, such as overtime, postage, and utilities, against expenditures projected through the year-end, thus providing a projected deficit or surplus amount for each line item. However, as mentioned earlier in the report, the spending plan figures used do not provide a reasonable basis for comparison because the department does not ensure the figures agree with its actual spending authority.

We also found that the department does not always attempt to solve problems identified in its monthly reviews. The department's Financial Management Handbook requires each institution to submit a corrective action plan along with its monthly review, if it is projecting a deficit. However, when we selected four institutions that projected deficits in their monthly reviews and requested copies of their corrective action plans, the department was able to provide only one plan, which did not provide any corrective actions designed to curtail expenditures and merely attempted to justify the fiscal position presented. As evidence that some institutions do prepare corrective action plans, the department provided two plans submitted with April 2001 monthly reviews. Although we found that the corrective actions appeared reasonable, the plans did not address all major line-item deficit areas, such as utilities and workers' compensation.

The department does not always attempt to solve problems identified in monthly reviews of each institution's spending.

In our conversations with several department budget staff, we learned that neither the analysts nor the budget managers enforce the requirement for the institutions to provide corrective action plans. The analysts told us they spend much of their time reviewing the methods used by the institutions to project expenditures instead of analyzing the problems and issues presented. Because the monthly reviews are the department's primary mechanism to monitor expenditures, the lack of meaningful analysis and corrective action results in ineffective efforts to monitor program and institutional spending.

In response to these and other concerns, the department began implementing a new on-line monthly review process in late August 2001. The overall format of the on-line review is largely the same as the old monthly review, but the spending plan amounts and current and year-to-date expenditures are electronically imported from the department's accounting system by headquarters staff to each entity's monthly review, eliminating the need for time-consuming data entry at the program and institution level. Additionally, the on-line monthly review includes formulas for approved methods for projecting expenditures on certain items. As long as programs and institutions use one of the preprogrammed projection methods, the central administration budget analysts will not have to spend time verifying and correcting them, as has been the case in the past. By reducing data entry and verification time, the new system allows more time for analysis of the problems and issues presented and for preparation of corrective action plans.

The department is also currently in the process of contracting to create and implement an automated budget-tracking and reconciliation process. This process, to be part of the on-line monthly review system, is expected to include an automated tracking and reconciliation of the spending plan, spending authority, allocation of funds, and projected expenditures. Although this process should provide information that is more accurate for fiscal management purposes, as of October 2001 the official contract for it had not yet been finalized.

The Department Conducts Three Different Types of Fiscal Reviews

- A **monthly budget plan review** is conducted by each program and institution to identify any funding surpluses or shortfalls. The review consists of comparing projected expenditures for the remainder of the fiscal year to the spending plan.
- A **fiscal review** is an annual assessment conducted by a fiscal review team of the December monthly budget plan for each program and institution. Program managers and wardens are responsible for providing explanations and justifications for any deficiencies identified by the review team.
- A **deficit review** is a two-week examination of any program projecting a large fiscal shortfall. Conducted by a deficit review team, this review focuses on the management practices, expenditure projections, and major fiscal issues of each program examined.

To its credit, the department also conducts two other types of reviews to identify and address fiscal and operational problems. The fiscal review is completed for all institutions by central administration analysts and consists of a thorough analysis of the December monthly budget plan. The fiscal review process requires institution management, including the warden, to answer questions regarding the institution's fiscal position to the fiscal review team and the headquarters management team. The process results in recommendations from the fiscal review team and management team regarding identified problems as well as some follow-up measures to monitor institution and program implementation. Although it only occurs annually, the fiscal review is more effective than the monthly review because it involves management and holds each institution directly accountable for preventing and correcting problems. Fiscal reviews are also conducted for the Community Correctional and Central Administration programs; however, the department did not conduct monthly reviews for these programs until September 2001.

The deficit review, implemented in fiscal year 2000–01, focuses on the operational issues causing budget shortfalls at institutions projecting deficits. These two-week reviews generate findings and requests for corrective action plans. We reviewed two deficit review packages and determined that the institutions supplied corrective action responses to the review teams. Deficit reviews provide the institutions and headquarters with individualized reviews focused on problem areas. The department has stated that it is compiling a database to track progress and evaluate common issues found in the reviewed institutions that could be considered statewide fiscal concerns. Additionally, the department is preparing individual memos for reviewed institutions that address the issues found by the deficit review teams. As of September 2001, the department had completed 13 deficit reviews for the institutions projecting the largest funding shortfalls and plans to continue its reviews for all 33 institutions.

Proper use of its monthly review process, combined with alignment of its spending plan to spending authority, would allow the department to adequately monitor its fiscal condition.

The department's chief financial officer told us that the department did not intend to eliminate the requirement for programs to submit corrective action plans during the monthly review process but that extensive budget and institutions staff turnover led to the requirement's being discontinued for a period of time. She stated that the corrective action plans generated from the department's fiscal and deficit reviews served as a temporary replacement for the monthly corrective action plans. However, in light of the department's recurring problems with overspending its originally funded amounts, taking corrective action annually seems inadequate. Furthermore, the department has expressed a desire to move toward an on-line, real-time financial, human resource, and risk management system that interfaces its databases statewide. The department has contracted with a consulting firm to initiate project planning and procurement of the system. However, the bulk of the department's expenditures consist of payroll expenditures, which are only available on a monthly basis, not minute-by-minute or daily. If the department ensures that its spending plan agrees with its spending authority and it uses its monthly review process properly, the department would be able to monitor its fiscal condition and take appropriate action to correct problems.

The Department Can Also Improve Its Deficit Analysis Process

In an April 2001 hearing before the Joint Legislative Audit Committee, the department's chief financial officer cited 12 causes for the department's recurring budget shortfalls. However, we found that the department's conclusions as to the origins of these deficits were often lacking what we would consider sound financial analysis. Although we ultimately found that several of its asserted causes have some merit, we found that others do not.

The department's budget officers told us that the department generally identifies where its surpluses and deficiencies occur by comparing its spending plan to the year-to-date spending plus projected expenditures for the remainder of the year. Our review, however, revealed that the department rarely performs this comparison. We requested and reviewed the department's support for the 12 asserted causes of its recurring deficiencies and, as shown in Table 3, found that the department's analyses for 8 of the 12 assertions lacked comparisons of its total year-to-date and projected expenditures to either its spending plan or its spending authority. Of the five areas in which the department received funding augmentations to address claimed deficiencies, the department made the comparisons for only three—one of which, for underbudgeted leave, we had performed a comparison in a previous audit. For one of the remaining two cases, the department could not provide support for the budget or base amounts it used in its calculations. In any event, even if the department did compare its expenditures to the spending plan, the results would not be accurate because, as we discuss earlier in this chapter, the department had not aligned its spending plan with its spending authority.

Furthermore, of the seven remaining unfunded items that the department asserts contribute to its budget shortfalls, all department support, with the exception of correctional officer vacancies, lacked comparisons of expenditures to its spending plan or spending authority and therefore did not demonstrate the effects of the expenditures on the department's actual fiscal situation. For example, the department's analysis of price increases was rudimentary, showing only that the California consumer price index for goods increased recently. As discussed later in this section, the department should be able to absorb increases in the cost for goods because of large surpluses in its spending plans for total operating expenses and equipment.

Similarly, the department provided evidence that state employees recently received unfunded general salary and merit salary increases without any comparison to its spending authority for salaries. Although the department documentation did not support the need for additional funding, unfunded salary increases might contribute to shortfalls related to custody staff, as we point out later in this chapter. Moreover, although we agree with the department's assertion that custody staff vacancies are a significant cause of department shortfalls, the department could not provide us with an analysis supporting this cause-effect relationship until September 2001—five months after the department described it to

TABLE 3

The Department's Analyses of Factors Causing Budget Deficiencies Are Often Inadequate

Asserted Cause of Deficiency	Department Provided Adequate Analysis and Support for Deficiency Calculation	Department Could Not Provide Support for the Budget or Base Values Used in Analysis	Department Analysis Lacked Comparison of Budget-to-Actual Expenditures
Correctional officer vacancies			•*
Unfunded merit salary increases			•
Price increases			•
Operational costs due to lawsuits			•
Unfunded general salary increase on overtime			•
Reductions in inmate populations			•
Administrative segregation overflow			•
Utilities costs†	•‡		
Guarding/transportation for inmate medical needs†	•‡		
Underbudgeted leave for staff†	•§		
Workers' compensation costs†			•
Contracts for pharmacy and medical services†		•	

* The department could not provide us with an analysis of budget-to-actual expenditures until five months after it made this assertion.

† The department received funding augmentations to address claimed deficiency.

‡ The base numbers used in the fiscal analysis were agreed upon figures determined by the Department of Finance.

§ The department relied on our analysis from a January 2000 audit report and did not provide an updated comparison of budgeted-to-actual hours used.

the Legislature. Furthermore, we found its analysis flawed in that it calculated the number of positions needed based on the full amount of overtime premium and not the regular pay component needed to replace the overtime costs.

Although the department's assertions may be valid, for 3 of the 12 asserted causes of shortfalls, the department could not demonstrate that its expenditures increased. For example, the department asserted that unfunded operational costs due to lawsuits caused a deficiency. However, the department not only failed to compare budgeted amounts to anticipated total expenditures but also stated in its analysis that it could not capture the total operational costs that resulted because it did not have a mechanism to track these costs. The analysis was further flawed in that two cases given in support of the department's position were related to expenditure line items that had been granted additional funding in fiscal years 2000–01 and 2001–02. In addition, the department provided us with documentation showing a slight decrease in its inmate populations recently; however, the department did not demonstrate how this condition caused it to incur a deficit. Finally, the department's analysis of administrative segregation overflow showed that the department needed additional positions to fill this need but did not include an analysis of its budget-to-actual expenditures for this area.[9]

Because the department's analyses of the causes of its budget shortfalls were poor, we reviewed four years of the department's spending plans and expenditures for five of its expenditure categories: utilities, overtime, workers' compensation, medical guarding and transportation, and professional contracting for health and medical services. The department asserts that these expenditure categories contributed to its budget shortfalls. Although our analyses indicated that department costs did increase significantly for all five areas, as shown in Table 4, we found that in all cases the amount reflected in the department's spending plan actually declined in one or more years.

Finding it odd that the department would decrease its spending plan allocation for items in which expenditures continued to increase significantly, we requested an explanation from the department. The department was unable to provide an adequate response for reducing its spending plans for four of these five items and attributes its spending plan decrease for overtime to a cut in spending authority.

The shortfalls in individual line items can be manipulated by the department's postings to its spending plans.

The shortfalls in individual line items can be manipulated by the department's postings to its spending plan. Therefore, we believe that any consideration of funding augmentations should be based on a broader analysis of the department's fiscal condition to determine if the department could use other surpluses to offset deficiencies in particular line items. For example, despite significant growth in the department's utility costs, we found that the department could fully absorb the cost increases with surpluses in other areas of its operating expenses and equipment budget. These surpluses are partially attributable to standard cost factors, as previously discussed. Specifically, although the department requested and received $29 million in additional funding

[9] *Administrative segregation* is the separation from the general prison population individuals who are deemed immediate threats to the safety of themselves or others, institution security, or the integrity of an investigation.

TABLE 4

Department Spending Plans Decreased in Some Fiscal Years Despite Increasing Expenditures (In Millions)

Line-Item Description	Fiscal Year 1997–98	1998–99	1999–2000	2000–01
Utilities				
Spending plan	$ 69.0	$ 68.0	$ 63.0	$102.1
Expenditures and encumbrances	67.6	68.8	72.9	107.2
Overtime				
Spending plan	87.3	79.6	109.1	116.8
Expenditures and encumbrances	113.0	124.1	161.3	204.1
Workers' compensation				
Spending plan	73.7	69.8	64.5	82.3
Expenditures and encumbrances	73.6	85.2	102.7	110.1
Medical guarding and transportation				
Spending plan	3.5	4.4	0.5	4.8
Expenditures and encumbrances	12.2	16.0	19.1	27.6
Professional contracting for health and medical services				
Spending plan	80.7	71.8	71.0	117.5
Expenditures and encumbrances	129.5	129.4	145.9	193.6

for utilities in fiscal year 2000–01, our analysis shows that the department actually had a surplus of $37.4 million in the Institution Program for total operating expenses and equipment in that year. Although the $37.4 million includes the $29 million deficit augmentation, the surplus indicates that the department did not need the augmentation and could have used its original surplus of $8.4 million to further offset shortfalls in other areas. The department's chief financial officer told us that the surpluses in operating expenditures and equipment were the result of department-wide purchasing freezes. We did not review the department's inventory levels to determine the impact of the freezes. As this example illustrates, by failing to include a comparison of both line-item and overall budgeted amounts in its fiscal analyses, the department cannot ensure that its existing funds are not already sufficient to cover any increases in expenditures. However, to conduct such an exercise, the department should first ensure it aligns its spending plan with its spending authority. Although we discuss increased overtime and workers' compensation further in a later section, we did not conduct any detailed analysis of the department's Health Care Services Program, including pharmacy contract costs.

ESCALATING COMPENSATION COSTS FOR CUSTODY STAFF CONTRIBUTED $147 MILLION TO THE BUDGET SHORTFALL

Overtime expenditures for custody staff have increased from $89 million to $176 million (94 percent) over the past four years.

Annual compensation expenditures are responsible for more than half the total increase in the department's expenditures for the Institution Program during the past four years. In fact, annual compensation expenditures for custody staff increased by 29 percent, from more than $1.3 billion in fiscal year 1997–98 to $1.7 billion in fiscal year 2000–01.[10] Over this same period, custody overtime expenditures increased 94 percent, from $89 million to $176 million. A comparison of these fast-growing expenditures to the department's spending authority for fiscal year 2000–01, as Table 5 illustrates, reveals that approximately $147 million of the department's actual $197 million funding shortfall in fiscal year 2000–01 related to custody staff compensation.

TABLE 5

Elements of Custody Staff Compensation Contributing to the Department's Shortfall in Fiscal Year 2000–01

Type of Compensation	Budget	Expenditures	Variance
Salaries and wages	$1,165,755,675	$1,174,361,652	$ (8,605,977)
Temporary help	3,467,096	54,182,483	(50,715,387)
Overtime	88,599,152	176,087,861	(87,488,709)
Totals	**$1,257,821,923**	**$1,404,631,996**	**$(146,810,073)**

Sources: The governor's budget salaries and wages supplement plus funding augmentations for fiscal year 2000–01 and the California State Accounting and Reporting System.

The increases in custody staff compensation and the growth in expenditures largely result from custody staff's excessive overtime, which accounts for approximately $87 million of the shortfall. The department could save the State about $42 million in overtime costs by filling its custody vacancies and reducing the excessive use of overtime. Controlling the excessive use of custody staff's sick leave would also significantly reduce the amount of staff and funding needed.

[10] Annual compensation includes regular salaries and wages, overtime, wages for temporary help, benefits, and other related costs.

Various factors hindered our analysis of the causes for the department's past shortfalls. For example, we could not ascertain whether the department had augmented a particular spending plan category during the year because the department could not always provide us with adequate support for how it used these additional funds. Consequently, we could not determine the specific expenditures that exceeded the department's original spending plan and that created the shortfall. In addition, because the department can move funds between line items, we could not determine whether the department had used for another purpose additional funds for particular line items.

Nevertheless, most of the department's remaining budget shortfall appears related to significant increases in the costs of pharmacy contracts and medical services in the Health Care Services Program. Department expenditures in this area increased significantly from approximately $130 million in fiscal year 1997–98 to $194 million in fiscal year 2000–01. The 2000–01 amount exceeded the department's augmented spending plan figure by more than $76 million. The department also received approval for another augmentation of approximately $83 million for fiscal year 2001–02, which should resolve this shortfall. Because of this augmentation and our separate audit of the department's medical pharmacy procurement costs currently in progress, we did not examine this shortfall further.

Ongoing funding augmentations that the department has received appear adequate to resolve its shortfalls. However, the department needs to prepare annual spending plans that truly reflect how the department expects to use its funds. The department should report these plans periodically to the Legislature during the budget-building process. Ultimately, this information should allow the Legislature and the department to align the department's spending authority with its needs.

Eliminating Excessive Overtime Would Save the State at Least $42 Million Per Year

An analysis of overtime expenditures for custody staff in fiscal year 2000–01 showed that 72 percent of overtime could have been avoided.

The department could greatly reduce its budget shortfall by replacing costly overtime expenditures, which the department pays at 1.5 times the regular pay rate, with regular time pay when possible. In fiscal year 2000–01, the department incurred more than $176 million in overtime expenditures for custody staff—nearly double its spending authority of $89 million. A department analysis of its fiscal year 2000–01 overtime expenditures revealed that 72 percent of the overtime was foreseeable, meaning that a scheduled person on regular time could have filled the need—if available. Applying this percentage to the department's $176 million overtime figure indicates that approximately $127 million in overtime expenses was potentially avoidable. Replacing overtime pay with regular pay eliminates the overtime premium, resulting in a net savings to the State of $42 million.

Although the department generally has an adequate number of budgeted custody positions, the department has been unable to fill them completely. As Table 6 displays, our analysis revealed that the department needs to fill more than 1,500 vacant custody staff positions, out of its nearly 24,000 budgeted positions, to have adequate staff to reduce overtime spending. Additionally, if the department fills these positions, it believes that the new custody staff will aid institution staff in coping with the increase in inmate violence it has experienced in recent years.

TABLE 6

Filling Custody Staff Vacancies Would Reduce Excess Overtime and Temporary Help Expenditures (Fiscal Year 2000-01)

	Correctional Officers	Sergeants	Lieutenants	Totals
Number of positions needed to resolve excess overtime	**1,204**	**269**	**74**	**1,547**
Number of positions needed to resolve excess temporary help	**906**	**33**	**14**	**953**
Department vacancies as of June 30, 2001	1,999	217	90	2,306

Further, as Table 5 on page 30 indicates, the department has used temporary help that costs much more than its spending authority allows. To resolve this shortfall, the department must hire approximately 950 new custody staff in addition to the 1,500 positions needed to reduce overtime expenditures. With permanent, full-time staffing at this level, the department could not achieve the state-mandated 4.9 percent salary savings and would have to seek approval from the Legislature to eliminate this requirement for custody staff.[11] However, if the department

[11] Salary savings reflect personnel cost savings resulting from vacancies due to employee turnover. The amount of budgeted salary savings is an estimate generally based on past years and is withheld from a department's budget.

is unable to fill this many positions, it should request approval from the Legislature to realign its funding and to use its spending authority for temporary help at the higher-than-budgeted levels. According to the department's chief financial officer, the department has had difficulty hiring and retaining custody staff. However, in light of the potential $42 million in overtime savings, the department should consider taking more aggressive action in recruiting and hiring custody staff.

The department could also reap significant savings by reducing the use of sick leave by custody staff. As we pointed out in our January 2000 report titled *California Department of Corrections: Poor Management Practices Have Resulted in Excessive Personnel Costs,* exorbitant use of sick leave by custody staff is one of the primary causes of the department's overtime costs. The report revealed that the department could save between $17 million and $29 million per year by reducing sick-leave use to reasonable levels. However, at the time of the report, the department's efforts to curb the use of sick leave had been ineffective. Despite the department's efforts since then to bring sick leave under control, sick-leave use still greatly exceeds budgeted levels. As shown in Figure 3 on the following page, custody staff used nearly 2.3 million hours of sick leave during fiscal year 2000–01, an amount that is more than 64 percent higher than the department's budgeted level of 1.4 million hours.

Custody staff used nearly one million more hours of sick leave than budgeted in fiscal year 2000–01.

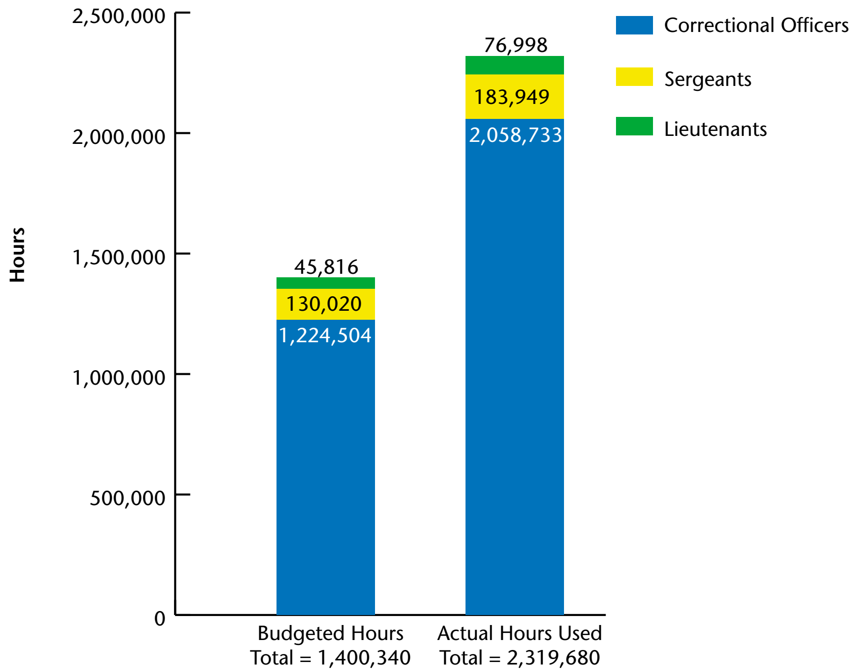
We also found during this audit that if the department were able to reduce its current use of custody staff sick leave to budgeted levels, the department would need to fill 505 fewer positions than the 1,547 we point out in Table 6 on page 32 if it wants to avoid costly overtime and properly align the department's expenditures for custody staff with its spending authority. We continue to believe that the department could avoid many of these hours through improved information, progressively aggressive disciplinary actions, and incentives for employees with excellent attendance.

Inadequate Funding for Custody Staff Has Also Contributed to the Budget Shortfall

Not only has the department's budget suffered from excessive costs for overtime and sick leave, but its budget has also received inadequate funding relative to the department's actual costs for custody staff. As Figure 4 on page 35 shows, department expenditures for each filled custody staff position exceeded funding levels by $4,300 to $8,400 per year, depending on the level of

FIGURE 3

Use of Sick Leave by Custody Staff Significantly Exceeded Budgeted Levels for Fiscal Year 2000–01



Sources: Budgeted hours from the department's fiscal year 1999–2000 post assignment schedules, adjusted to 2000–01 levels, and actual hours from the State Controller's Office Leave Benefit Usage review.

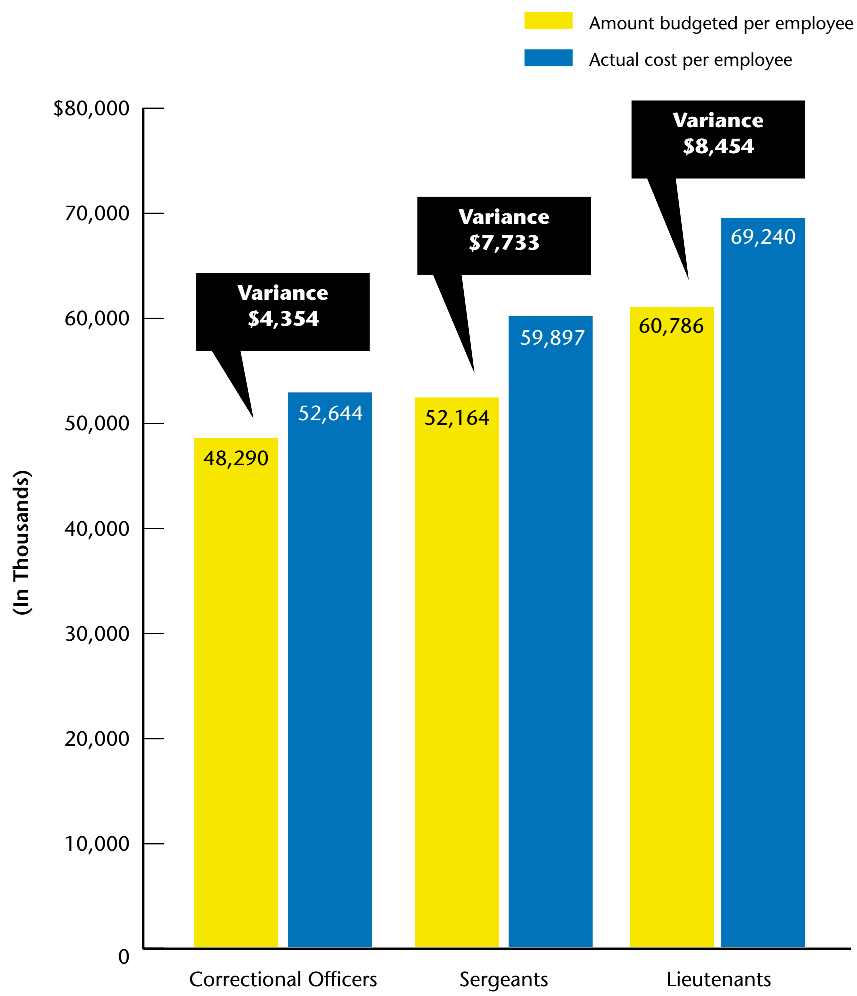
the staff. Although Table 5 on page 30 indicates that the department had a small deficit in its budget for regular salaries and wages, the department had more than 2,300 vacancies in custody staff positions; therefore, the department should have had a surplus of funds. We found that the total funding shortage was nearly $105 million for fiscal year 2000–01. However, this deficiency will increase to $116 million if the department fills all its authorized custody staff positions. The department attributes to several factors the funding shortfall for custody staff, and these include the lack of funding for merit and general salary increases over the past several years. Premium pay, such as shift differentials, probably also contributes to the discrepancy.

The department has received approval for increases in funding in the fiscal year 2001–02 budget act that are adequate to cover its total expenditures for 2000–01. This funding increase was granted with the approvals of the department's fiscal year 2000–01 augmentations for contingencies and emergencies and the augmentations for new programs. However, it is unclear how much recent executive orders and directives from Finance will affect the department's budget.

In any event, because of the difference in the department's spending authority and how it spends its funds, the department should prepare and present a report to the Legislature three times per year: on the 15th of November, February, and May. This report as illustrated in the Appendix, Table 10, should present the department's spending authority, a detailed spending plan, and its actual and projected expenditures. The dates for reporting coincide with the Legislature's budget-building time frames.

FIGURE 4

The Costs for Custody Staff Exceeded the Amount Budgeted for Fiscal Year 2000–01



Sources: Payroll History file from the State Controller's Office and governor's budget.

Presenting to the Legislature its spending plans and realistic projections for where it expects expenditures to occur will clarify the causes of any departmental fiscal challenges and allow for resolution during the budgeting process. Ultimately, this effort should result in spending authority and spending plans that realistically reflect where the department is spending its funds. Although the department's chief deputy director agrees that such a report would be valuable, she is concerned about having adequate staff resources and time to prepare the report. However, we believe that after the department prepares the first report, subsequent reports will not require significant staff resources or time to complete. In addition, department staff expressed concern about its ability to report separately the salary and wages expenditures for custody and noncustody staff as well as its ability to report operating expenditures as they relate to inmates or staff. However, this information is available through the department's accounting system and can be sorted into these categories, as Table 10 on page 62 shows, using a data analysis system the department already has in place.

Reporting its projected expenditures, spending authority, and spending plan to the Legislature should aid in the resolution of fiscal challenges during the budgeting process.

THE DEPARTMENT HAS FAILED TO ACT PROMPTLY TO CONTROL WORKERS' COMPENSATION COSTS

Escalating workers' compensation costs are a key contributor to the department's budget shortfall. Although the department recently had its overall spending authority for workers' compensation reduced, we found that the department has failed to take required action to control these costs. Until it does so, the department cannot ensure that it is effectively managing these costs and protecting the best interests of the State.

A 1985 executive order required all state agencies to establish or rededicate safety committees and other resources toward achieving the reduction of work-related injuries, illnesses, days lost from work, and overall workers' compensation costs. However, we found that the department has not fully complied with this order. In addition, the department has no mechanism for monitoring potentially fraudulent workers' compensation claims and therefore cannot determine what impact fraud has on these costs.

Having a strategy to control workers' compensation costs is important in light of the $36 million increase in these costs for the Institution Program over the past four years.

The department's failure to comply with the executive order is disconcerting in light of the department's escalating workers' compensation costs. Specifically, the department's General Fund expenditures for workers' compensation in its Institution Program increased from $73.6 million in fiscal year 1997–98 to $110.1 million in fiscal year 2000–01. This amount exceeded the department's spending plan amount, contributing approximately $27.8 million to its budget shortfall for fiscal year 2000–01. The shortfall is partly a result of a $23.3 million reduction in the department's spending authority for workers' compensation in fiscal year 1999–2000. However, its failure to attempt to control escalating costs is also important and further demonstrates the department's failure to take corrective action to protect the State's interests when the department identifies fiscal problems.

In response to its shortfall and escalating costs, the department finally requested in a fiscal year 2000–01 budget change proposal a redirection of two staff members to begin cost containment efforts. In this proposal, the department also requested and received increased funding for workers' compensation, which should resolve the shortfall by fiscal year 2001–02. The department is also finally beginning to develop a strategy for controlling workers' compensation costs. The department provided us with working documents outlining its basic approach for mitigating these costs. However, the plan does not yet have the full approval of executive department management; thus, the impact of the plan on the department's costs is yet to be seen. However, if the plan is eventually successful at controlling costs, the department may not need the full amount of increased funding it is to receive.

RECOMMENDATIONS

To manage its fiscal operations more effectively, the department should ensure that its spending plans correspond to its spending authority.

In light of its continuing budgetary challenges, the department should report the status of its financial position to the Legislature using the format described in the Appendix. The department should submit this report each November, February, and May.

To better match its budgeted funds to its actual expenditures, the department should periodically review and update its standard cost formulas.

To improve its fiscal management, the department should fully implement and use its new automated process for reviewing its monthly budget plans and ensure that it prepares and implements corrective action plans to aid in the resolution of projected spending deficiencies.

To improve the way it analyzes areas contributing to budgetary challenges, the department should compare year-to-date and projected expenditures to a budget that aligns with the department's spending authority. The department should perform this analysis in conjunction with an overall program analysis.

To resolve its funding shortfall for custody staff, the department should act aggressively to fill all vacant custody staff positions and continue its effort to lower to budgeted levels its staff's use of sick leave.

To help reduce workers' compensation costs, the department should continue to develop and implement a mitigation strategy as soon as possible. ■

CHAPTER 2

The Department's Contracting Practices and Cost Controls Need Improvement

CHAPTER SUMMARY

The California Department of Corrections (department) has not ensured that its contracting practices protect the best interests of either the State of California (State) or the department's subcontractors, and it has paid too much for contract administration. Moreover, the department needs to improve its cost-saving practices related to year-end administrative budgets and legal expenditures. The department could also save hundreds of thousands of dollars each year and place hundreds of additional parolees into the workforce by expanding its use of the Jobs Plus Program (Jobs Plus) and by eliminating the Offender Employment Continuum Program (Continuum). If it negotiates contracts using the indirect-cost rate that federal programs use, the department could save even more in future Jobs Plus contracts. Our review showed that during fiscal year 2000–01, the department paid but could not support $23,989 in indirect contract costs to the Jobs Plus contract administrator, which is the California State University, Sacramento, Foundation (foundation).[12]

The department has also exhibited inconsistencies in its monitoring of the payment and performance of subcontractors. Specifically, the department does not make sure that subcontractors who provide services to drug-addicted parolees receive prompt payment. Lengthy delays in receiving payments can have severe repercussions for these subcontractors, forcing some to rely on costly lines of credit to meet their financial obligations and threatening the solvency of others. Our audit also revealed that the department's monitoring of subcontractors is inadequate in some cases and excessive in others. Consequently, the department is not allocating its limited resources in the most efficient, effective manner to ensure the accuracy of contractor invoices and the satisfactory delivery of services. Further, in

[12] *Indirect costs* are expenses incurred that, by their nature, cannot be readily associated with a specific unit or program. Like overhead expenses, indirect costs are prorated to the organization's unit or program that benefits from their incurrence.

some cases the department relies exclusively on the primary contractors to perform invoice and site reviews on subcontractors—even if the contractor and subcontractor are the same entity. The department's failure to impose consistency in contract monitoring wastes the State's resources and fails to protect state interests adequately.

Further, most of the department's reported savings from a recent reorganization relates to what we consider normal year-end budget activities and not to reorganizing. Because the department did not implement any performance measures related to the reorganization, we were unable to assess any impact of the reorganization on the department's operations.

Finally, the department has made significant progress recently in developing and implementing strategies designed to reduce the occurrence and consequences of costly legal action against the department. Nevertheless, until the department fully executes all strategies, it will not be able to manage legal claims and costs as effectively as possible.

THE DEPARTMENT'S CONTRACTING PRACTICES DO NOT ALWAYS PROTECT THE BEST INTERESTS OF THE STATE OR SUBCONTRACTORS

We did not uncover any significant issues when we conducted limited testing of the department's contracting process to determine whether the department awarded contracts based on the qualifications specified in the bidding process and whether it amended contracts according to state contracting policies. However, we found other contracting areas in which the department can reduce its costs and improve program performance. During our analysis, we reviewed a sample of contracts for the job placement, substance abuse, and work furlough programs that the department provides.

Changing Job Placement Programs Would Increase Placements and Reduce Costs

One parolee job placement program costs the department $824 more per job placement than does a comparable program.

The department could save hundreds of thousands of dollars per year and place hundreds of additional parolees into the workforce by expanding its use of Jobs Plus and eliminating Continuum. Although both programs are very similar and specialize in placing parolees into the workforce, data provided by the department for fiscal year 2000–01 show that Continuum cost the department $1,439 per placement compared with only $615 per placement through Jobs Plus, a difference of $824 per parolee placement. These figures represent all contractor costs incurred, including administrative costs. Had the department used Jobs Plus to place the 869 parolees who obtained jobs through Continuum in fiscal year 2000–01, it would have saved $716,360—funds that the department could have used to offset funding shortfalls in other areas.

The department could have saved over $700,000 and provided jobs for over 500 more parolees by expanding one of its parolee job placement programs and eliminating another.

Not only is Jobs Plus less expensive than Continuum, but Jobs Plus is also a much more efficient program, serving more than twice as many parolees and finding job placements for more than four times as many parolees as Continuum does. Of the 3,079 parolees the department referred to Continuum in fiscal year 2000–01, only 869, or 28 percent, were placed in jobs. During the same period, about 45 percent of the parolees referred to Jobs Plus received job placements. Based on the placement rates for fiscal year 2000–01, had the department referred to Jobs Plus instead of to Continuum the 3,079 parolees who received Continuum's services, an additional 534 parolees would have obtained jobs. Successful placement of parolees is important because the department feels that employed parolees have much lower recidivism rates than those without jobs.

Placements through Continuum are more costly than those through Jobs Plus because of the basis used for payments. For Jobs Plus, the department contracts with an administrative intermediary—the foundation—and pays subcontractors for each placement. For Continuum, the department contracts directly with the provider and pays for services rendered regardless of whether placements occur. According to the manager of the department's job placement programs, both programs provide similar services to parolees who are not quite "job ready." Consequently, the difference in the payment bases is unwarranted. In addition, the department assumes a greater administrative responsibility for managing each Continuum contract, and this responsibility increases costs for the department. According to data provided by the department, for fiscal year 2000–01, the Continuum contract cost the department about $17,000 more in internal administration costs than did Jobs Plus. Obviously, the department could save this additional amount if the department discontinues the Continuum contract. Further, the department incurred the additional cost despite the fact that Continuum serves and places far fewer parolees into jobs than does Jobs Plus. The department is considering paying Continuum for each placement or workshop graduate, but it needs to explore the legal ramifications of changing the contract reimbursement process for the existing Continuum providers.[13]

The parole administrator for the department's job placement programs believes that comparison of placement rates for the two programs may be misleading because some participants may have acquired job placement and retention skills through the Continuum workshop but obtained employment on their own. Thus, the number of Continuum placements may be understated. In Jobs Plus the contractors can track and count such placements as "indirect" placements. Because the department does not track its Continuum workshop participants after graduation, it cannot determine if any of those not placed directly by Continuum obtained employment on their own. However, even if we considered all Continuum workshop graduates as job placements, the placement rate for fiscal year 2000–01 would rise to just 38 percent, still well below the Jobs Plus placement rate of 45 percent.

The same parole administrator also believes that the 40-hour Continuum workshop provides more comprehensive training than does the 18-hour Jobs Plus workshop and therefore places parolees in better jobs. However, the manager could not provide support for this belief. The department has commissioned an analysis of the two job placement programs that will compare the recidivism rates of participants. Results from this analysis should clarify whether or not the Continuum placements do indeed have higher quality than those obtained through Jobs Plus.

The Department Is Paying Excessive Indirect Costs for Its Jobs Plus Contract

By failing to enforce its contract provision requiring the submission of a cost allocation plan, the department paid its contractor nearly $24,000 in unsupported costs.

Although the cost of placing parolees into jobs through Jobs Plus is less than that of Continuum, we found that the department paid $23,989 in unsupported indirect contract costs to Jobs Plus during fiscal year 2000–01. Although the department negotiated a specific indirect-cost rate to be applied to contract costs, the Jobs Plus contract language also requires Jobs Plus to prepare and submit an actual cost allocation plan to the department. A cost allocation plan is designed to ensure that there is an equitable distribution of indirect costs to all the contractor's

[13] The Continuum workshop is a mandatory 40-hour program providing parolees with cognitive training, job preparation, and job retention information.

programs or operations; however, the department has not enforced this provision. At our request, the foundation submitted an indirect cost allocation plan. According to this plan, the foundation can support indirect costs of only $253,298 for fiscal year 2000–01—despite charging the department $277,287. Fortunately, the Jobs Plus contract also stipulates that the department can recover any payments made in excess of the supported indirect costs. The department's office of compliance is scheduled to perform an audit on the Jobs Plus contract in fiscal year 2001–02, and the department plans to recover any unsupported costs found during the audit.

Had the department negotiated the indirect cost rate that is used for federal programs, it could have saved more than $230,000 in fiscal year 2000–01 for one of its job placement programs.

The department could save more in its Jobs Plus contract by negotiating the indirect-cost rate used for federal programs. This kind of negotiation is not uncommon; in fact, the department negotiated a rate below the federal rate in its previous contract with Jobs Plus. Using the federal rate in place at the time the department agreed to the current contract would have resulted in indirect costs of only $42,852, thus saving the department $234,435 in fiscal year 2000–01. As of July 1, 2000, the federal indirect-cost rate has increased but still will save the department more than $150,000 if the department uses this rate instead of the current contract rate. However, it should be noted that the federal rate represents the maximum allowable rate that can be charged in federally funded contracts. Contracting departments are free to negotiate a lower rate, and they should negotiate a rate based on an understanding of the actual administrative costs. Regardless of the rate that the department uses, the $277,287 in indirect costs that the department was charged in fiscal year 2000–01 to support an administrative staff of three part-time employees seems unreasonable.

In response to our finding, the department stated that the foundation uses a cost allocation plan approved by the Division of Cost Allocation at the U.S. Department of Health and Human Services. The department further states that the plan justifies indirect-cost rates for grants awarded by the federal government and that the department should not have to reexamine the cost factors used in determining an approved cost rate established by a federal agency. The department's response concerns us because, despite the department's endorsement of the federally approved indirect-cost rate, the department did not negotiate this rate for Jobs Plus. As previously stated, had the department done so, it would have saved more than $150,000. The department also contends that the $277,287 in indirect costs does not specifically support an office of three but instead supports a

$2.4 million program. However, despite this reasoning, the department agreed to pay far more in indirect costs as a percentage of all costs for the fiscal year 2000–01 contract than it did for its previous contract with the foundation.

Some of the Substance Abuse Program's Subcontractors Do Not Receive Prompt Payments

Because of numerous complaints about delayed payments to some subcontractors for the department's Office of Substance Abuse Programs (OSAP), we reviewed the payment process for these subcontractors. Our review of a sample of invoices revealed that some subcontractors have to wait as long as four months to receive payment. Such lengthy delays can have severe repercussions for these subcontractors, forcing some to rely on costly lines of credit to meet their financial obligations and threatening the solvency of other subcontractors. The department is contributing to the payment problems by failing to establish a mechanism for subcontractors to communicate their problems and by not enforcing contractual payment provisions.

Studies have shown that a successful substance abuse treatment program for inmates depends on having a strong in-prison treatment program combined with an equally strong after-care program to serve inmates released from prison. One study showed that inmates who completed both in-prison and after-care treatment programs had an average recidivism rate of only 27.4 percent. In contrast, more than 75 percent of all other subject groups in the study returned to custody within three years of their release.

Although contract provisions require payment within 15 days of invoicing, some department contractors have had to wait as long as four months for payment.

OSAP uses three tiers of contractors to help provide a seamless continuum of care for drug-addicted inmates on their release from prison. The primary contractor is the in-prison substance abuse program. Because individuals may be incarcerated in regions far from where they are released (the counties of their last known residence), it is not practical for primary contractors to oversee after-care treatment for all parolees in all regions. Therefore, OSAP uses substance abuse coordinating agencies (second-tier contractors) to arrange the appropriate treatment services for parolees at community-based organizations (third-tier contractors) that provide several services in various locations. In this report, we refer to both second- and third-tier contractors as subcontractors.

Several subcontractors have filed complaints with OSAP because they have not received prompt payments from the primary or second-tier contractors. In response to these complaints, OSAP currently sends correspondence to the delinquent contractor, who is responsible for reviewing and paying invoices, informing the contractor of its contractual obligation and lack of compliance. However, we believe that OSAP should be more assertive in ensuring that its subcontractors receive prompt payments.

All OSAP contracts we reviewed require contractors to have a system in place to reimburse subcontractors within 15 days after the contractors receive an invoice. However, our testing indicates that subcontractors rarely receive payment within 15 days of submitting their invoices. In our review of 45 invoices, we found that primary contractors average approximately 40 days to process invoices and send checks to second-tier contractors. We also found that second-tier contractors average approximately 32 days to send payments after receiving invoices from third-tier contractors. In one case, a third-tier contractor's check was not sent until 120 days after the second-tier contractor received the invoice. Lengthy delays in receiving payments could threaten the solvency of subcontractors and may have a harmful effect on OSAP's performance. Many of these nonprofit subcontractors are small and poorly equipped to handle the cash-flow problems that arise when payments are late.

Utilizing three tiers of contractors for its inmate and parolee substance abuse treatment program contributes to lengthy payment delays for the department's subcontractors.

Further, although it originally believed that involving the primary contractor in the invoice-processing chain for the second- and third-tier contractors would improve communication, the department does not ensure a smooth path for the payment of invoices. OSAP has recently amended all contracts involving primary contractors so that in the future the department will pay second-tier contractors directly, thereby eliminating one layer of potential payment delays. Also, in future contracts, OSAP plans to make payments directly to second-tier contractors. We agree that this change should improve the timelines for payments because the department can advance up to 25 percent of each fiscal year's contract cost.

OSAP could make a greater effort to ensure that all contractors are paid in accordance with the terms of the contracts. Although the department's use of three tiers of contractors appears to be a creative way to improve program success, this structure makes it difficult for third-tier contractors to know whom they should call regarding slow invoice payments. When a third-tier contractor has not received payment, it has no way of knowing whether the delay occurred because the second-tier or primary contractor has not been paid or because some other problem exists.

This weakness in communication occurs at least in part because OSAP has not fulfilled another contractual responsibility requiring it to establish and maintain open lines of communication among all levels of contract parties, including third-tier subcontractors. Had it done so, OSAP could have been aware of more payment delays, such as those we identified in our review, and it could have acted more aggressively to solve the problems. Department contracts clearly stipulate the need for such communication, and OSAP does conduct regular meetings with primary and second-tier contractors, providing a forum for informal discussion of issues such as payment delays. However, the department makes no effort to communicate with third-tier contractors. While the third-tier contractors may attend these meetings, these subcontractors do not receive formal invitations or notifications about meeting times and dates.

When asked why OSAP does not actively encourage the third-tier contractors to communicate concerns, the program's assistant director told us that the complex contracting system and the multiple tiers of contractors often isolates program staff from third-tier contractors. However, the assistant director also stated that the biggest problem that program staff sees with payment delays occurs when the program is not informed that a problem exists. Because the department does not provide third-tier contractors with a contact person or number, payment delays may go unnoticed by the department for extended periods.

Inconsistent Contract Monitoring Does Not Ensure the Best Use of State Resources

The department's monitoring of subcontractors is inconsistent, ranging from inadequate in some cases to excessive in others. As a result, the department is not allocating its limited resources in the most efficient, effective manner to ensure the accuracy of contractor invoices and the satisfactory delivery of services.

The department's oversight of its subcontractors is excessive in some cases and inadequate in others.

The best illustration of the inconsistency in the department's monitoring of subcontractors is a comparison of how it oversees subcontractor invoices for Jobs Plus and OSAP. According to the department, it reviews all subcontractor invoices for Jobs Plus even though the foundation (the primary contractor) also performs this function. Because it duplicates the foundation's work, the department appears to be using its limited resources inefficiently. State law declares that waste and inefficiency in state government undermine the confidence of Californians in government and reduce the State's ability to address vital public needs. The department's Jobs Plus program manager realizes that there may be excessive duplication of responsibilities in reviewing invoices and in other areas and is developing strategies to limit the duplication of administrative duties.

For OSAP the department relies solely on its primary contractors to review invoices from second- and third-tier contractors. This situation is of greatest concern when the holder of the primary contract also holds a second-tier contract and in some cases a third-tier contract, and it demonstrates weaknesses in the department's internal and administrative controls. For example, the second-tier contractors in three of the four regions of OSAP are also primary contractors. In fact, second-tier contractors in three regions have 10 of the 30 primary contracts in OSAP. Since the department does not maintain a list of its third-tier contractors, we were unable to determine the extent to which those who have primary or second-tier contracts also have third-tier contracts. Nonetheless, under the current system, the department is essentially relying on contractors to police their own invoices for much of the after-care billing that the department receives.

For its substance abuse treatment programs, the department often relies on private contractors to review and approve their own invoices.

State law requires each state agency to establish and maintain a system or systems of internal accounting and administrative control. Internal controls are necessary to provide public accountability and are designed to minimize fraud, abuse, and waste of government funds. The law also states that elements of a satisfactory system of internal accounting and administrative control should include a system of authorization and record-keeping procedures adequate to provide effective accounting control over expenditures. Further, the law requires that, when detected, weaknesses must be corrected promptly.

In acknowledging our concern, the department has essentially eliminated one tier from the payment process on these three-tier contracts. However, this action does not fully address our concern about the lack of impartial reviews for subcontractor invoices. The department stated that eliminating one tier of contractors allows it to review all second-tier contractor invoices, but review of third-tier invoices is still left to the primary contractor.

Finally, while OSAP does perform periodic site reviews of its primary and second-tier OSAP contractors, it does not perform adequate site reviews of its third-tier contractors. According to the OSAP's assistant director, the department does have parole agents in the field who occasionally visit third-tier contractors, usually in response to incidents such as drug arrests. However, the parole agents do not monitor for contract compliance. Also, the department was unable to provide a list of third-tier contractors and has no set schedule or contract monitoring tool for these visits. The department's contracts require it to perform site visits of its third-tier providers, but site monitoring for the third-tier contractors is generally left to the second-tier contractors, which are sometimes the same entity. Without conducting some form of independent, periodic review, the department cannot ensure that second-tier contractors adequately fulfill their role and ensure the delivery of appropriate contract services by third-tier providers. The department agrees that monitoring of third-tier contractors is necessary but feels that it does not have the staff it needs to perform site visits on its third-tier providers.

Because the department does not perform periodic reviews of its third-tier contractors, it cannot ensure that contracted services are adequately provided.

We also found that as of September 30, 2001, the department had not conducted annual reviews of contractors in its Community Correctional Reentry Centers Program (reentry centers) as required by its operations manual. This work furlough program, operated through the department's Parole and Community Services Division, uses contracted facilities to house low-risk inmates who are scheduled for parole within 120 days of admittance into a reentry center. According to the department, it conducts quarterly reviews of reentry centers, focusing on issues such as facility staffing and living conditions. However, the annual reviews are designed to be more thorough because they include both an operational and an administrative review. According to the deputy parole administrator for reentry centers, the department began conducting these annual reviews in October 2001.

THE DEPARTMENT OVERSTATED THE BENEFITS OF A RECENT REORGANIZATION OF ITS CENTRAL ADMINISTRATION PROGRAM

Nearly 70 percent of the department's reported savings for fiscal year 2000–01 were the result of what we consider normal year-end budget activities rather than the recent reorganization.

In an April 2001 hearing before the Joint Legislative Audit Committee, the department's chief financial officer reported that a reorganization of the department's Central Administration Program was responsible for cost reductions of $8.6 million in fiscal year 1999–2000 and $19.6 million in fiscal year 2000–01. Further reductions of $23.2 million are projected for fiscal year 2001–02. However, our analysis revealed that the majority of the reported savings for fiscal year 2000–01—$13.6 million—relates to what we consider normal year-end budget activities and not to the reorganization. In addition, because the department did not implement any performance measures related to the reorganization, we were unable to assess any impact of the reorganization on the department's operations.

In response to its projected budget shortfalls, the department evaluated its Central Administration Program so that it could identify duplications of services and nonessential operations, consolidate similar functions, increase efficiency, and collapse redundant organizational layers. The result of this effort was an April 2000 reorganization plan outlining position and program reductions in its Central Administration Program that would allow for the permanent reallocation of the savings to fund institutional operations. The department identified 92.4 positions for elimination by July 2001 and other operational reductions planned for implementation over a three-year period. We found that the department successfully redirected the funding that it intended to redirect during the first two years of the plan.

However, as Table 7 on the following page shows, more than $12 million of the $19.6 million portrayed as cost savings was, in reality, achieved by the department's disencumbering completed contracts and redirecting surplus funds.[14] For example, $4.3 million of the savings resulted from a Standard Automated Preventative Maintenance System contract completed during fiscal year 1999–2000. Another $1 million came from a surplus of funds that the department no longer needed due to completion in a previous year of a remediation project for an underground storage tank. Although we agree that

[14] *Disencumbering* is removing an earmark on funds to pay for goods and services not yet received.

TABLE 7

Most of the Department's Cost Savings in Fiscal Year 2000–01 Came From Disencumbering Completed Contracts and Surplus Funds Rather Than From the Reorganization Strategy

Category	Amount Saved	Percent of Total Cost Savings
Completed contracts and surplus funds	$12,098,751	62
Eliminated positions*	3,228,212	17
Operating costs associated with personnel reductions and reclassifications	439,562	2
Reductions in uses of overtime and temporary help	614,785	3
Travel reductions	424,965	2
Consolidation of data center	1,750,000	9
Other	1,026,470	5
Total	**$19,582,745**	**100**

* See Table 8 for a further analysis of this data.

these savings are important, they should be uncovered during any normal year-end budget exercise that identifies current-year expenses not needed in future years and not attributed to the reorganization.

Approximately $3.2 million of the savings claimed for fiscal year 2000–01 consisted of salaries from 92.4 eliminated positions. The department reported that it was able to cut the positions by consolidating services and eliminating duplicate or unnecessary positions. However, Table 8 indicates that more than half of the 92.4 positions cut during the reorganization were already vacant; therefore, the department was already saving over $1.5 million. The department's chief financial officer contends that the vacancies were the result of a hiring freeze imposed by the directorate and that its actions resulted in a permanent reallocation of funds to field operations. However, as part of its normal year-end budget activities, the department should be evaluating and eliminating unnecessary positions.

TABLE 8

Most of the Positions Eliminated as Part of the Department's Reorganization Were Already Vacant During Fiscal Year 2000–01

Divisions in Central Administration Program	Positions Cut During Reorganization	Total Reported Savings	Number of Vacant Positions	Total Savings From Vacant Positions
Administrative Services Division	24.1	$ 538,577	18.6	$ 437,614
Health Care Services Division*	10.3	485,858	8.8	443,897
Institutions Division*	8.5	255,683	4.5	144,372
Office of Community Resources	3.0	123,593	3.0	123,593
Office of Compliance	7.0	346,870	0.0	0
Business Management Division (formerly the Planning and Construction Division)†	23.5	829,751	4.5	149,097
Parole and Community Services Division	5.0	132,577	3.0	62,685
Departmental Training	4.0	220,962	1.0	59,887
Other	7.0	294,341	4.0	167,130
Totals	**92.4**	**$3,228,212**	**47.4**	**$1,588,275**

* This division differs from the department program of the same name. The division supplies administrative support for the department's 33 institutions.

† Six filled positions, resulting in total savings of approximately $300,000, were eliminated as a result of the phase-out of the Year 2000 organization.

Although the department's reorganization did result in some cost savings, the actual savings are much less than the department portrays. The department contends that it completed the reorganization project as originally designed and that the savings identified were a result of its efforts. However, we were unable to assess whether the department's reorganization resulted in improved operations because it did not implement any performance targets in its reorganization plan. Such targets, which would include measurable outcomes of the department's plan, would enable the department to gauge the success of its reorganization. We encourage the department to continue conducting activities designed to identify unneeded funds and positions on an annual basis. For example, Section 12349 of the California Government Code requires departments to eliminate all positions that are vacant for six consecutive months. Also, the State Administrative Manual requires departments to assess earmarked funds each June to disencumber amounts not needed.

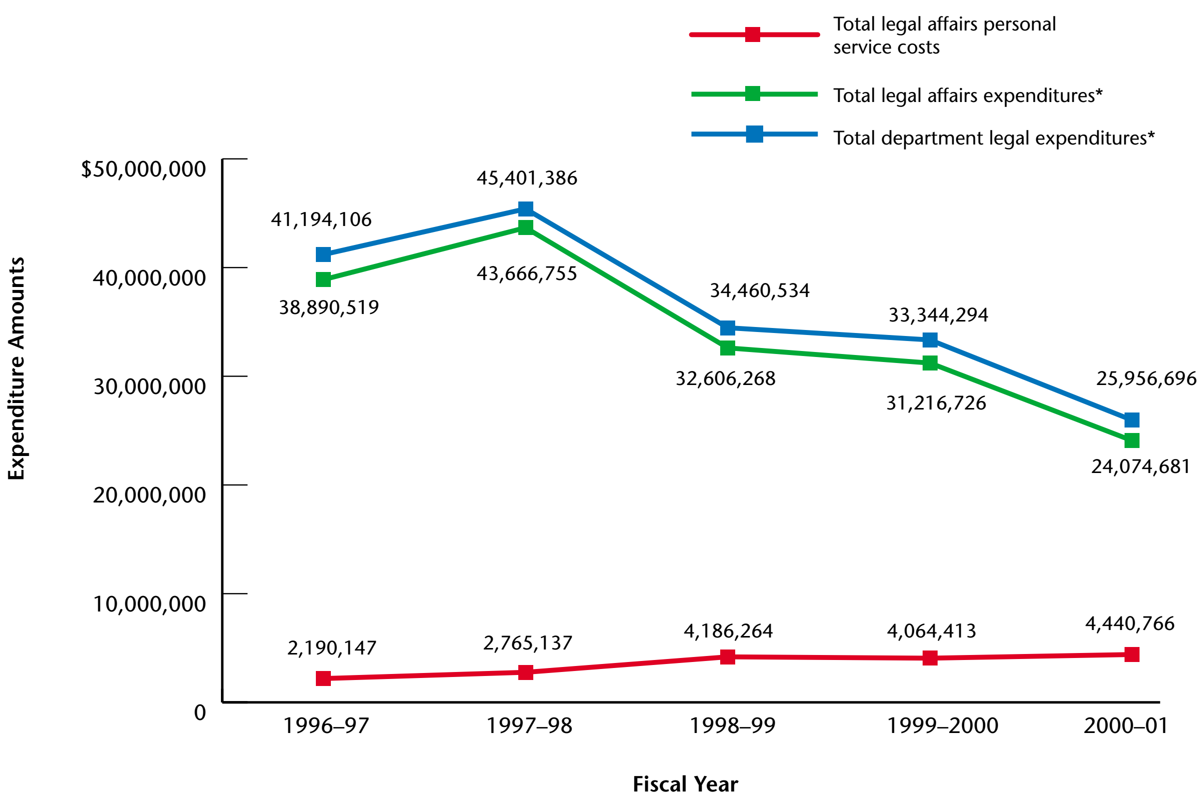
THE DEPARTMENT CAN IMPROVE ITS EFFORTS TO MINIMIZE LEGAL EXPENSES

The department has made significant progress recently in developing and implementing strategies designed to reduce the occurrence and consequences of costly legal action against the department. Nevertheless, the department will not be able to manage legal claims and costs as effectively as possible until it has fully implemented its plans.

The Legislature, concerned about the increasing budget in the department's Legal Affairs Division (legal affairs), requested that we determine whether the department is anticipating and addressing conditions that give rise to lawsuits. Figure 5 displays the fact that although the personal services expenditures for legal affairs nearly doubled in the last four years, total department and division legal expenditures actually decreased. Indeed,

FIGURE 5

Personal Service Costs Have Risen While the Department's Overall Legal Expenses Have Declined



* Includes settlement and judgment costs.

according to department records, settlements and judgments against the department also declined from a high of approximately $27 million in fiscal year 1997–98 to approximately $8 million in fiscal year 2000–01.

The department attributes the doubling in personal services costs to increased responsibilities related to class action lawsuit settlements and to its assumption of duties formerly handled by the Attorney General's Office. Beginning in April 2000, legal affairs refocused its duties and further restructured its operational unit to begin implementing strategies designed to enhance its services and reduce the department's legal costs and exposure to legal liability. These strategies, which introduce a risk management component, represent a significant transformation for legal affairs—from what was traditionally a reactive structure to one that is more proactive.

Developing a reliable case-tracking system that includes attorney costs and settlement and judgment costs would allow the department to identify areas of recurring liability and expense.

As Table 9 on the following page illustrates, legal affairs has not fully implemented 3 of the 13 strategies it designed to control the cost of legal actions against the department. Most importantly, although one of the department's strategies is to implement a database to track legal cases by type, such as sexual harassment or use of force, the system is inadequate. According to legal affairs staff, the system has numerous problems and is so unreliable that staff could not use the system to produce a report of its contents for us. Aware of its limitations, the department is planning to implement a new system in fiscal year 2002–03; however, the department also needs to ensure that the system is complete. Staff also told us that because the system is relatively new, it only includes partial case records for the past year. In addition, although the system design includes tracking of all settlement and judgment costs and will soon include external attorney costs, it does not include internal attorney costs by case. Therefore, the department cannot get a complete picture of the costs related to different case types. The manager of legal affairs agrees that tracking all costs, including internal attorney costs, related to cases would be useful; however, he feels that the department needs funding for software, hardware, and staffing to accomplish this goal. Nevertheless, we think it would be relatively simple to have legal affairs staff track its time by case number and compile this information along with external costs for each case. A reliable case-tracking system would enable the department to identify areas in which it is recurrently exposed to potential liability. This, in turn, should enable the department to effect changes in policy, procedures, and training to reduce or eliminate certain areas of liability exposure.

TABLE 9

The Department Has Not Fully Implemented Its Strategies for Mitigating Legal Expenses

Strategy	Status
Assess all incoming cases to develop defense or settlement strategies	Implemented
Create the Litigation Response Unit to address civil cases initiated by inmates	Implemented
Create the Major Litigation Unit to address class action cases initiated by inmates	Implemented, although not formalized as its own unit as of October 2001
Implement a case-tracking database to identify areas of greatest mitigation potential	Partially implemented
Oversee outside attorney billings to ensure that they are appropriate	Implemented
Create the class action notebook to monitor progress of compliance with class action judgments	Ongoing
Initiate early case involvement by reviewing daily incident reports and Board of Control claims to identify potential cases*	Ongoing
Create critical-incident protocols to establish procedures for obtaining evidence crucial to defending potential lawsuits	Partially implemented and used on a case-by-case basis; standardization and full implementation projected for April 2002
Improve training for litigation coordinators focusing on obtaining evidence to defend against civil actions	Ongoing; one training session conducted in March 2001 and the next session is scheduled for April 2002
Design and begin civil liability training to inform custody employees about what to expect and what to do if they are sued	Not yet implemented; pilot training program completed recently incorporated into the department's management training module but not given to custody staff as of October 2001
Conduct monthly meetings with division directors to discuss potential legal liability issues	Ongoing
Ensure that inmates have pursued all avenues of administrative relief before filing against the department for civil damages	Ongoing
Perform independent review of trial counsel settlement recommendations	Ongoing

* The Board of Control is now known as the California Victim Compensation and Government Claims Board. Before filing lawsuits against the State, individuals and organizations must first exhaust their administrative remedies, including filing claims with this state board.

Table 9 also shows that the department has not yet implemented its civil liability training for custody staff, although it has completed a pilot training session. Prompt implementation of this training program is important because custody staff is the primary contacts for inmates, who are the source of much litigation against the department. Although custody staff receives considerable civil liability training when hired, this ongoing training program should help custody staff maintain vigilance regarding matters that could potentially result in litigation.

Furthermore, as Table 9 illustrates, the department has yet to standardize its critical-incident protocols. Currently, it handles each critical incident individually. Correspondence goes to the institution warden and requests that specific documents be sent to legal affairs. As each incident occurs, staff makes a critical-incident sheet for that type of incident; however, the department plans to develop one standardized critical-incident sheet on which legal affairs will check items needed for each case. Information sent to legal affairs aids in the discovery process and helps it to prepare for potential lawsuits before they are filed. The head of legal affairs told us that although staff shortages hinder its implementation efforts, he is projecting full implementation of its mitigation strategies near the end of fiscal year 2002–03.

RECOMMENDATIONS

To maximize its use of contract funds and ensure that it does not incur unnecessary charges, the department should pay its Continuum subcontractors for each placement of a parolee, just as it does with Jobs Plus contractors. The department should also implement strategies to encourage higher job placement rates for the Continuum contractors.

If the department cannot improve Continuum's placement rates and reduce to a level commensurate with Jobs Plus the cost for each placement, the department should eliminate the Continuum Program and expand Jobs Plus to accommodate those parolees whom the department would have referred to Continuum. In addition, if department staff find the Continuum workshop superior to that of Jobs Plus because it leads to lower recidivism rates, the department should consider revising its contract with Jobs Plus to include a workshop that is similar to that of the Continuum.

The department can further maximize the use of contract funds without incurring unnecessary charges by obtaining and reviewing cost allocation plans for all contracts and by seeking cost recovery for any unsupported costs. Further, the department can attempt to negotiate the indirect-cost rate that the foundation charges federal programs, or a lesser rate, in future contracts.

To help ensure that contractors and subcontractors receive payments in a timely manner, the department should establish a formal complaint mechanism for contractor payment delays or other problems, and it should assist in resolving identified problems.

To use its resources more efficiently and to make sure that contractors and subcontractors comply with contract provisions, the department should standardize its contract monitoring procedures and include requirements that its primary contractors provide a list of all subcontractors, including their addresses and primary contacts, so that the department can identify any possible self-dealing and take appropriate action to ensure that all invoices from entities that subcontract with themselves are legitimate. The department should also establish a procedure for reviewing a sample of invoices, such as 10 percent, for all other subcontractors and establish procedures to schedule and conduct periodic site visits for all contractors and subcontractors.

To improve the soundness of its fiscal policies, the department should continue to conduct evaluations of its budget needs as part of its year-end budget activities and eliminate funding for unneeded items or positions.

To manage potential litigation costs as effectively as possible, legal affairs should fully implement all its proposed cost-cutting strategies, fix or replace its case-tracking database to provide a stable tracking system for all settlement and judgment costs, and consider the viability of tracking all internal and external attorney costs associated with each legal case.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

Date: November 27, 2001

Staff: Ann Campbell, CFE, Audit Manager
Tyler Covey, CPA, CMA
Jeana Kenyon, CMA, CFM
Mandi Gallardo
Mike Urso
Robert E. Graham
Chris Shoop

Blank page inserted for reproduction purposes only.

APPENDIX

Suggested Format for a Report to the Legislature on Departmental Operations

The California Department of Corrections (department) needs to improve the way it communicates with the Legislature, particularly regarding funding that the department has spent and plans to spend during the remainder of the fiscal year. A report in the format displayed in Table 10 in this appendix would show the Legislature the relationships between the basis on which the department requests and augments funding, the reallocations of spending authority by the department to meet spending priorities, and the expenditures that the department actually makes.

The department should prepare separate reports for the Institution Program (Program 21), the Health Care Services Program (Program 22), the Community Correctional Program (Program 31), and the Central Administration Program (Program 41) within budget act item 5240-001-0001. The department should prepare and submit each report to the Legislature on an ongoing basis as of the month ended September 30, December 31, and March 31. Each report should include the actual expenditures for the previous year as of June 30 for comparison and should be submitted on the 15th of November, February, and May. The September 30 document is needed because it should reflect the department's first-quarter modifications to its spending plan; for example, the September 30 report should reflect how the department finances overtime caused by excessive use of sick leave and other factors. The December 31 document should reflect the fall inmate population adjustment and be available shortly after the governor's budget is issued. The March 31 document should identify any anticipated shortfalls and adjustments needed at about the same time the May revision is issued.

As Table 10 on page 62 shows, the four primary categories of expense for the Institution Program are custody staff salaries and wages, noncustody staff salaries and wages, employee benefits, and operating expenses. A modest amount of subordinate detail is needed to differentiate either major categories of expense such as regular wages from overtime or to differentiate the basis of estimating budgeted costs, such as the department's existing methods of estimating inmate-driven operating expenses and staff-driven operating expenses. The department can prepare a similar report for the department's other programs; however, the department will need to substitute *parolees* for *inmates* in the information for Program 31.

Figures for the first column, *prior-year expenditures and encumbrances,* are readily obtainable from the department's accounting system. To offer perspective, we have populated this column and total budgeted amounts for the department.

The second column, *governor's budget,* is also easily obtained. Some of the data, such as budgeted regular wages for custody staff, come directly from data in the salaries and wages supplement to the governor's budget.[15] Alternatively, to make compiling budget information easier, the department could report salary costs for security and transportation costs and nonsecurity and transportation costs. Other budgeted data, such as budgeted inmate-driven operating expenses and staff-driven operating expenses, only exist in the department's supporting schedules, such as its Schedule 11. The department may need to allocate 2 of the 16 expense categories between inmate-driven, staff-driven, and other operating expenses; however, these amounts should reconcile in total to the governor's budget.

The third column, *budget deliberations,* reflects changes to the governor's budget based on changes that occur between the numbers appearing in the governor's budget and the spending authority in the budget act. These postings allocate those changes to the relevant cost category, which should not be problematic if the intent of the change is clear.

The fourth column, *budget act,* adds the numbers in columns two and three. While this level of detail does not appear in the budget act, it reflects an understanding of the detail underlying the amounts in the budget act.

The fifth column, *additional appropriation authority,* is similar in concept to the third column except that the fifth column reflects legislatively approved changes to spending authority that occurred after the passage of the budget act.

[15] Salary savings should be removed from *Salaries and Wages*.

The sixth column, *revised spending authority,* adds columns four and five and reflects an allocation of the total spending authority to the various cost categories.

Column seven, *department spending plan,* shows the spending plan as the department allotted it to programs and institutions and should agree in total with column six.

Column eight, *to-date expenditures and encumbrances,* represents the expenditures and encumbrances incurred to date during the fiscal year. This data is easily obtained from departmental accounting records and is reported in the department's monthly budget reports.

Column nine, *projected expenditures and encumbrances*, reflects the department's periodic projections of remaining expenses by category. This column should indicate the department's realistic expectation of future spending for each category. This information is generally already computed in the department's monthly budget reports.

Column ten, *total expenditures and encumbrances,* is the addition of columns eight and nine. This column represents the revised total anticipated spending by category.

Column eleven, *projected surplus (deficit),* is column seven minus column ten.

TABLE 10

Format for Reporting Departmental Operations to the Legislature: Sample Report for the Institution Program

Expense Category	1 Prior-Year Expenditures and Encumbrances	2 2001–02 Governor's Budget	3 Budget Deliberations	4 Budget Act	5 Additional Appropriation Authority	6 Revised Spending Authority	7 Department Spending Plan	8 To-Date Expenditures and Encumbrances	9 Projected Expenditures and Encumbrances	10 Total Expenditures and Encumbrances	11 Projected Surplus (Deficit)
Salaries and wages for custody staff*											
Regular wages	$1,181,140,057										
Temporary help	61,606,129										
Overtime	182,858,666										
Other wages	19,682,804										
Total custody salaries and wages	**1,445,287,656**										
Salaries and wages for noncustody staff											
Regular wages	555,026,598										
Temporary help	18,868,045										
Overtime	21,222,958										
Other wages	4,056,307										
Total noncustody salaries and wages	**599,173,908**										
Total salaries and wages	**2,044,461,564**										
Benefits											
Workers' compensation†	110,143,158										
Other benefits	300,582,528										
Total benefits	**410,725,686**										

Expense Category	1 Prior-Year Expenditures and Encumbrances	2 2001–02 Governor's Budget	3 Budget Deliberations	4 Budget Act	5 Additional Appropriation Authority	6 Revised Spending Authority	7 Department Spending Plan	8 To-Date Expenditures and Encumbrances	9 Projected Expenditures and Encumbrances	10 Total Expenditures and Encumbrances	11 Projected Surplus (Deficit)
Operating expenses and equipment (OE&E)											
Inmate driven OE&E	365,169,468										
Staff driven OE&E	165,115,347										
Other OE&E	48,268,191										
Total operating expenditures and equipment	**578,553,006**										
Other expenses											
Unallocated											
Distributed administration	349,058,937										
Other	(260,184,788)[‡]										
Total other expenses	88,874,149										
Grand totals	**$3,122,614,405**	**$3,492,959,000**		**$3,245,770,000**							

* Figures differ from those in Table 5 due to the addition here of captains and other custody staff positions at headquarters.

† This category includes disability leave.

‡ This figure includes more than $265 million in internal cost recovery from other programs.

Blank page inserted for reproduction purposes only.

Agency's comments provided as text only.

Department of Corrections

November 14, 2001

Elaine M. Howle*
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

RESPONSE TO BUREAU OF STATE AUDITS REPORT ON FISCAL AND PERSONNEL MANAGEMENT PRACTICES

This memorandum responds to the issues identified in the recent Bureau of State Audits' Report on the California Department of Corrections: "Its Fiscal Practices and Internal Controls Are Inadequate to Ensure Fiscal Responsibility."

While acknowledging some of the deficiencies cited in the report with respect to the Department's past fiscal practices, it is disappointing that the report fails to: 1) recognize the proactive efforts and significant improvements the Department has made toward improving its fiscal management practices since December 1999; 2) identify the information technology challenges the Department faces, and 3) acknowledge the significant impact that the loss of experienced and knowledgeable staff has had on the Department. As an example, there has been a 95 percent turnover in our Budget Office staff over the past two years. 1 2 3

Workloads are extreme in support areas of the Department. Training and adequate staffing have been hampered by hiring freezes and budget restrictions over the past three years. Workload and lack of adequate resources have significantly impacted recruitment and retention of Support Services' staff. This report, by failing to recognize the extraordinary efforts of the staff who have been tirelessly dedicated to improving our fiscal practices, will be a severe blow to staff morale. 4

In closing, my staff will continue to work diligently on the strategies that we have developed to improve our fiscal, contracting, legal, personnel management, and business practices. If you have any questions, please contact Wendy Still, Chief Financial Officer, Office of Financial Management, at 323-0218.

(Signed by: Edward S. Alameida, Jr.)

EDWARD S. ALAMEIDA, JR.
Director
Department of Corrections

Attachment

*California State Auditor's comments begin on page 77.

DEPARTMENT OF CORRECTIONS
RESPONSE TO THE BUREAU OF STATE AUDITS REPORT
NOVEMBER 14, 2001

CHAPTER 1

Poor Fiscal Management and Budget Shortfalls Plague the Department

1. Bureau of State Audits Recommendation:

"To improve its ability to manage its fiscal operations, the Department should ensure that its spending plans agree with its spending authority."

California Department of Corrections Response:

5 The California Department of Corrections (CDC) reconciled its budget authority to its spending plan for fiscal year (FY) 2000/01. However, the Department's year end adjusted reconciliation could not occur until numerous outstanding budget decisions were made which included: 1) 12 Budget Revisions and Executive Orders, 2) the Omnibus Bill, and 3) the May Revision population adjustment. These budget adjustments totaled $165 million.

6 As an interim measure the Department implemented a hiring and purchase freeze in January 2001 designed specifically to generate savings to offset field deficiencies identified in the spending plans. Budget change proposals were also submitted in Fall 2000, and the majority ultimately approved, to address institutional and health care base budget deficiencies for FY 2000/01 and 2001/02.

The spending plans for FY 2001/02 have been issued in accordance with the population levels established in the May Revision. Changes to the spending plans related to inmate population will coincide with adjustments to the spending authority as reflected in the ensuing Fall population change and May Revision. The spending plans will also be adjusted throughout the year when Executive Orders and Budget Revisions that impact CDC's spending authority are received. The Office of Financial Management (OFM) will continue to ensure that the final spending plans align with the final spending authority.

2. Bureau of State Audits Recommendation:

"In light of its continuing budgetary challenges, the department should report the status of its financial position to the Legislature, in the formula described in the appendix, in November, February, and May of each year."

California Department of Corrections Response:

7 The Department cannot comply with this recommendation due to lack of resources. The audit report recommends that the Department submit reports on its financial condition to the Legislature three times a year. This recommendation is premised on the assumption that the

Department has not aligned its spending plan with its spending authority. As noted previously, the Department already took action to ensure that this alignment is maintained throughout the year. In fact, the spending plans (allotments) in the statewide Monthly Budget Plan (MBP) reflect the alignment to the Department's spending authority. 7

As noted in the audit report, the Department expressed strong concerns regarding its ability to prepare the recommended report in the Bureau of State Audits (BSA) prescribed format. The Department does not have the staff resources or the data systems available to prepare such reports. What the auditors describe as "a modest amount of subordinate detail to differentiate between inmate-driven and employee-driven costs" and "readily obtainable" data to differentiate between custody staff and noncustody staff costs would in fact require a major reconfiguration of the Department's accounting system, as well as a substantial investment of staff resources and time. The Department records expenditure data in CALSTARS by program component that is summarized in the budget. The summary expenditure report format prescribed by the auditors is not readily distinguished in the current CALSTARS accounting reporting structure. In addition, the recent implementation of the MBP process was established to complete projected expenditures at the program level and does not provide the requested level of detail to complete the prescribed report. Current staff resources are not available to complete a data analysis system or to revise the MBP format to meet this level of reporting. 8

Also, the prescribed time frames for submittal of the reports are unrealistic, given the current parameters for securing month-end accounting data necessary for preparing the reports. The CDC management believes that it is unrealistic to impose a new reporting requirement that is impractical at a time when Departmental fiscal staff are already inundated with heavy workload, which will be exacerbated by the statewide fiscal circumstances. However, the Department is currently preparing a Feasibility Study Report related to the acquisition of an Enterprise Resource Planning Business Information System. If approved, the system will provide the Department with the ability to generate more detailed expenditure reports. 9

3. Bureau of State Audits Recommendation:

"To improve its matching of budgeted funds to actual expenditures, the department should periodically review and update its standard cost formulas."

California Department of Corrections Response:

Prior to the audit, the Department gained legislative approval of a Finance Letter submitted in February 2001 for $1.4 million to fund a Financial Management Process Redesign. The funding provided for a redesign of Departmental financial management practices and is being used, in part, to contract for an independent review to develop a new base budget methodology that will provide cost measurements (standard costs) that represent the Department's true costs. Once the new methodology is developed, the Department will periodically update it as necessary. In addition, the funding is also being used to: 1) create a temporary Financial Management Process Redesign Team that will work collaboratively with a contractor to prepare a Feasibility Study Report for an automated budget and business management system and 2) create a permanent Financial Management Standardization Team to focus on development of financial policy standards and to conduct ongoing statewide training.

4. Bureau of State Audits Recommendation:

"To improve its fiscal management, the department should fully implement and use its new automated monthly budget plan review process and ensure that corrective action plans are prepared and implemented to aid in the resolution of projected spending deficiencies."

California Department of Corrections Response:

The Department continues to improve its fiscal monitoring activities. In addition to the MBP, Annual Fiscal Reviews and Deficit Reduction Reviews, the Chief Financial Officer: 1) implemented the use of the MBP statewide, 2) is conducting monthly evaluations of the MBP (effective November 1, 2001), and 3) will conduct monthly fiscal briefings to the Directorate. During the MBP reviews, programs that have not submitted a corrective action plan (if applicable) will be contacted and required to do so.

The Department disagrees with the report finding that "…the Department does not always
10 attempt to solve the problems identified in its monthly reviews." The Department does address the problems as they are identified. However, many problems often require long-term solutions contingent upon policy decisions, legislative approval, union negotiations, legal requirements, budget change proposals, etc.

In early 2001, prior to any discussions with the auditors, CDC management contracted for the enhancement of a statewide MBP process to improve its fiscal management system. This action was initiated in recognition of the need to strengthen the Department's fiscal monitoring capabilities and ensure direct accountability for effective budget management. Historically, the monthly reviews had only been used to monitor the Institutions and Health Care Services programs. The statewide MBP now provides CDC management with timely assessments of the entire Department's fiscal condition and, as appropriate, requires corrective action plans from programs, to address potential deficiencies.

The MBP was fully implemented for departmentwide use in August 2001. Training on the MBP was provided to program and budget staff, with emphasis placed on their responsibility to perform critical analyses of the plans. Due to the steps taken to ensure that the Department's spending plan is aligned with its available funding authority, the MBP is serving as an effective financial management tool to monitor and control the Department's fiscal condition and take effective corrective action as necessary.

5. Bureau of State Audits Recommendation:

"To improve its analysis of areas contributing to budgetary challenges, the department should compare year-to-date and projected expenditures to a budget that is aligned

with the department's spending authority. The department should perform this analysis in conjunction with an overall program analysis."

California Department of Corrections Response:

As stated above, the MBP process is serving as an effective financial management tool for monitoring and controlling the Department's overall fiscal condition. The system, and the Department's other fiscal management processes, provide for the routine comparison of year-to-date and projected expenditures against the Department's spending authority. Contrary to statements in the audit report, the budget office manager is aware that a basic principle of sound financial management is to ensure that its "*official*" spending plan aligns with its *final* funding authority. The auditors actually interviewed, and in part quoted inaccurately, budget supervisors who were still in a training mode related to CDC budget processes. As previously indicated in the response, and as discussed under Recommendation Number 1 above, CDC's "*official*" spending plans for the 2000/01 FY reconciled at year end with budget authority. Finally, the budget and accounting managers maintain regular communications to ensure that the spending plan is aligned with budgeted authority throughout the year. 11

6. Bureau of State Audits Recommendation:

"To resolve its funding shortfall for custody staff, the department should take aggressive action to fill all vacant custody staff positions and continue aggressively pursuing means to bring down the use of sick leave to budgeted levels."

California Department of Corrections Response:

The Department agrees with the BSA that filling custody vacant positions would reduce overtime costs, which will more closely align the Department's budget authority with its spending plan (the excess in overtime expenditures is not funded). The Department has been aggressively pursuing enhanced recruitment policies (made possible by an increase in funding authority from the Administration and Legislature) with positive results. The number of cadets that graduated in FY 1998/99 was 1,214 versus 1,830 projected for FY 2001/02. This represents a 66 percent increase in graduates, which is expected to contribute to the reduction of unfunded overtime expenditures by reducing our vacancies. We will continue our aggressive recruitment efforts until we satisfy our staffing needs.

The Department continues to control custody staff's sick leave usage to the extent possible given the Federal and State laws (Family Medical Leave Act, the California Family Rights Act, and Section 233 of the Labor Code). These legal mandates are designed to protect employees' rights to use sick leave as appropriate. Additionally, the Department of Personnel Administration and employees view earned sick leave credits as a benefit and a right to be taken as necessary. Therefore, it is unrealistic to anticipate that our efforts will generate millions of dollars in savings. Due to the extreme hazardous working environment resulting from direct inmate contact, as the Director of CDC, I understand the need for legitimate use of sick leave. I will continue to take appropriate steps regarding the abuse of sick leave within current law and Bargaining Unit Agreements.

7. Bureau of State Audits Recommendation:

"*To help reduce workers' compensation costs, the department should continue its efforts to develop and implement a mitigation strategy as soon as possible.*"

California Department of Corrections Response:

In addition to the Department's ongoing efforts, the Directorate tasked the Disability Management Unit, Office of Environmental Health and Safety (OEHS) with the responsibility to develop a three-year Workers' Compensation Cost Containment Strategy Plan. The goal is to control the Department's Workers' Compensation costs and to bring the Department's percentage rate of increase in line with other State agencies over the next three-year period. The plan includes the following six areas which will aid the Department in controlling Workers' Compensation costs:

- Developing and implementing a fraud program.
- Partnering with other agencies.
- Identifying the role of the Return-To-Work Coordinator (RTWC).
- Developing tools to help case management.
- Providing education and training for the RTWCs.
- Developing ways to streamline the process.

The Legislature authorized six positions in the 2001/02 budget for a new program to assist in combating Workers' Compensation fraud within the Department. This program is called the "Workers' Compensation Suspicious Activity Program" (WCSAP). The WCSAP will monitor Workers' Compensation claims for potential fraudulent activity; market, train, educate, and provide information to management and employees on the consequences of obtaining benefits
12 fraudulently. This new program is currently being implemented.

The OEHS conducts annual RTWC training sessions to discuss Cost Containment Strategies, Workers' Compensation Fraud, Case Management, Reasonable Accommodations and New Workers' Compensation Case Law. These sessions include proactive education and training in occupational safety in areas such as Personal Protective Equipment, Bloodborne Pathogen, Tuberculosis (TB), Hepatitis, Bio-Hazardous waste, and Illness and Injury Prevention Program (IIPP), etc.

The BSA report cites the Department has not complied with the 1985 Executive Order to
13 establish safety committees, etc. This is inaccurate. The Department, through the Department Operations Manual, Section 31020.7 Safety Management Program and the California Code of Regulations, Title 8, Section 3203 Injury and Illness Prevention Program (IIPP) established programs and committees. Effective July 1, 1991, every employer was required to establish, implement, and maintain an effective IIPP. Several training sessions have taken place over the years and continue to take place through hands-on training provided in the Department's Management Training Program, Basic Supervisor Training, In-Service Training, New Employee Orientation, Annual Safety Coordinators Training and Safety Committee meetings.

In addition, the Department has dedicated resources that serve as RTWCs at each of our facilities, including seven RTWCs located in the headquarters' Office of Environmental, Health and Safety.

CHAPTER 2

The Department's Contracting Practices and Cost Controls Need Improvement

1. Bureau of State Audits Recommendation:

"To maximize its use of its contract funds and ensure it is not incurring unnecessary charges, the department should pay its Continuum subcontractors on a per-placement basis, as it does with Jobs Plus contractors. The department should also implement strategies to encourage higher job placement rates for the Continuum contractors. If the department cannot improve Continuum's placement rates and reduce costs per placement to a level commensurate with Jobs Plus, the department should eliminate the Continuum program and expand Jobs Plus to accommodate those parolees who would have been referred to Continuum. In addition, if the Continuum workshop is found to be superior to that of Jobs Plus in terms of providing better recidivism rates, the department should consider revising its contract with Jobs Plus to include a workshop that is similar to that of the Continuum".

California Department of Corrections Response:

The CDC has three employment programs that include: the Employment Development Department (EDD), Jobs Plus Program (JPP) and Offender Employee Continuum (OEC). Based on the existing data, the CDC believes it is too early to conclude that the JPP is more effective than the other two programs in reducing overall costs to the State. Cheaper program costs do not necessarily equate to better program effectiveness. To determine which of our three employment programs is most effective in reducing recidivism, two research studies are currently being conducted. The University of California, Irvine is conducting a comparative research analysis of the CDC's three employment programs. In addition, the California State University, San Marcos is conducting a process and outcome evaluation of all Preventing Parolee Crime Programs (PPCP), which includes the three employment programs. The latter study was mandated by the Legislature and an evaluation report will be submitted to the Legislature on or about January 1, 2004. (14)

The true cost savings to the State is the reduction in new prison commitments for employment program participants. Once these evaluations are available, the CDC will know which program was most effective in reducing recidivism and will make decisions on which programs warrant future funding.

To reduce the average cost of the OEC, the Department will:

- Increase parolee participation, thereby reducing the per-unit cost of the OEC.

- Examine site locations to determine maximum statewide use of all employment programs. For example, the Department is reducing the employment programs in Fresno where there is over saturation and increasing the number of employment programs in Los Angeles where there is greater need for parolee employment programs.

- Explore the feasibility of changing the reimbursement process to a fee for service for the existing OEC contracts.

<u>2. Bureau of State Audits Recommendation:</u>

"The department can further maximize the use of contract funds without incurring unnecessary charges by obtaining and reviewing cost allocation plans for all contracts and seeking cost recovery for any unsupported costs. Further, the department can attempt to negotiate the indirect cost rate the foundation charges federal programs, or a lesser rate, in future contracts."

<u>California Department of Corrections Response:</u>

The Department agrees that standardizing the indirect-cost rate for appropriate contracts may produce positive benefits. The Department will investigate the feasibility of adopting the federal indirect-cost rate for future contracts. Depending upon the outcome of the feasibility study, the Department may require the review of all cost allocation plans that exceed the guidelines developed. However, requiring the Department to review cost allocation plans for all contracts creates a workload and staffing issue which the Department does not have the
15 resources to address at this time. As an alternate solution, the Department will revise the current contract language to require the contractor to retain a current cost allocation plan and provide the document to the Department when requested for audit purposes (or if the rate exceeds the established guidelines as mentioned above). The Department will recover any unsupported cost(s) identified in an audit.

<u>3. Bureau of State Audits Recommendation:</u>

"To help ensure that payments to contractors and subcontractors are made in a timely manner, the department should establish a formal complaint mechanism for contractor payment delays or other problems and should assist in resolving identified problems."

<u>California Department of Corrections Response:</u>

While the Office of Substance Abuse Programs (OSAP) conducts regular forums and meetings to discuss a variety of contractual and fiscal problems in its system, it agrees that third-tier subcontractors have not been invited to attend. However, discussions with primary and second-tier providers have focused on strategies to streamline the payment process, with the primary objective to alleviate cash flow problems to all levels of service providers, including third-tier subcontractors. Additionally, the number of third-tier subcontractors throughout the State is approximately 550, making it problematic to include all of them in meetings.

Furthermore, OSAP has committed to its primary and second-tier contractors to conduct meetings in each of the four parole regions, and to include third-tier contractors. The objective of these meetings will be to discuss invoicing/payment issues and establish clear lines of communication. Specific discussions may include OSAP's requirement of all second-tier contractors to include a notification to all third-tier contractors of OSAP's address, telephone number, and an OSAP contact person to be notified if any payment problems occur.

The OSAP has also assessed the current payment flow and implemented changes to the current contracts, which allows a smoother and more efficient payment flow to all levels of service providers. Specifically, the modifications permit second-tier subcontractors to receive direct payments from the State Controller's Office, thereby eliminating the first layer in the original payment design. The invoice is initially approved by the contractor, then reviewed and approved by OSAP staff. The CDC Accounting Management authorizes the payment of invoices directly to the primary and second-tier contractors.

The Department concurs that contractors and subcontractors should be informed of Departmental contacts to communicate concerns and issues. Additionally, the Department will revise the contract language to provide contractors with Department personnel and phone numbers to address program contract and payment issues that may arise.

4. Bureau of State Audits Recommendation:

"To use its resources more efficiently and make sure that contractors and subcontractors comply with contract provisions, the department should standardize its contract monitoring procedures and include requirements that its primary contractors provide a list of all subcontractors, including their addresses and primary contacts, so the department can identify any possible self-dealing and take appropriate action to ensure that all invoices from entities that subcontract with themselves are legitimate. The department should also establish a procedure for reviewing a sample of invoices, such as 10 percent, for all other subcontractors and establish procedures to schedule and conduct periodic site visits for all contractors and subcontractors."

California Department of Corrections Response:

The Department concurs that effective contract monitoring is essential.

- The Department supports the necessity to capture subcontractor information for monitoring purposes and will revise the contract language to require the information for all future contracts.

- Prior to this audit, the Department developed a Contract Monitoring Handbook. The handbook was disseminated to the Department's programs and institutions and is available on our Departmental Intranet. In addition, the Contract Management Branch included, and will continue to include, the handbook and contract monitoring directions in training given to institution contract staff.

- The Office of Compliance working with the Contract Management Branch in a joint effort are developing training material to provide contract monitoring training to our major programs.

- The handbook addresses and requires adequate review of invoices. In addition to the regular review of invoices, the Department will investigate the feasibility of identifying and sampling contracts for review where problems are more likely to occur.

To streamline the administrative functions for the Jobs Plus Program (JPP), the Parole and Community Services Division (P&CSD) implemented (August 2001) a revised invoicing procedure that places the responsibility for the invoice review and approval process with the California State University, Sacramento Foundation (CSUSF). Also, the CSUSF contract was restructured to more clearly delineate each agency's responsibility in order to minimize and prevent overlapping administrative functions. It is anticipated that the new JPP contract will take effect in January 1, 2002.

The JPP contract is scheduled for audit in the current fiscal year. If during that audit (which will include a detailed examination of the CSUSF Cost Allocation Plan) disallowable costs are noted, they will be collected through the audit resolution process.

Current staffing allows contract compliance monitoring of all four Substance Abuse Services Coordinating Agencies (SASCA) regions, but not for third-tier subcontractors. Due to staff limitations, the OSAP currently relies on cost reports of subcontractors to be reviewed by primary contractors. The OSAP requires the primary contractors to maintain support documentation for all invoices. The OSAP will formalize policies and procedures for the review of documentation in support of invoices; however, this review will be reserved for limited cases based on current staffing levels. Although Parole Agents visit the third-tier contractors, they do not have primary responsibility to evaluate services and perform formal site reviews.

5. Bureau of State Audits Recommendation:

"To improve the soundness of its fiscal policies, the department should continue to conduct evaluations of its budget needs as part of its year-end budget activities and eliminate funding for unneeded items or positions."

California Department of Corrections Response:

The CDC will continue to evaluate program budget needs on an ongoing basis and realign funding as appropriate. In FY 1999/2000 the headquarters reorganization was a complex process that involved identifying duplication of services and nonessential operations; consolidating like headquarters' functions; increasing headquarters' efficiency by eliminating duplicative areas such as fiscal staff, and collapsing redundant organizational layers. As a result of this focused effort, a total of $23.1 million has been permanently cut from headquarters' allotments to offset field deficiencies. In FY 2001/02, 826 institutional support positions were permanently eliminated and the funding utilized to augment security salaries and wages to more closely align expenditures to budget authority.

6. Bureau of State Audits Recommendation:

"To manage potential litigation costs as effectively as possible, legal affairs should fully implement all its proposed cost-cutting strategies, fix or replace its case-tracking database to provide a stable tracking system for all settlement and judgement costs, and consider the viability of tracking all internal and external attorney costs associated with each legal case."

California Department of Corrections Response:

The CDC agrees with the recommendations of the BSA, and is taking all available steps to fully implement the recommendations. For example, Legal Affairs Division has created a pilot civil liability training program, and is in the process of working with the Staff Development Center to obtain the requisite certification from the Commission on Peace Officer Standards and Training and arrange scheduling for the training (which requires coordination with custody staff). Also, using the in-house expertise available, we are attempting to renovate our case-tracking system to the extent possible within existing resources.

Blank page inserted for reproduction purposes only.

COMMENTS

California State Auditor's Comments on the Response From the California Department of Corrections

To provide clarity and perspective, we are commenting on the California Department of Corrections' (department) response to our audit report. The numbers below correspond to the numbers we have placed in the response.

1 Throughout the audit report we recognize the department's efforts to improve its fiscal management practices. However, the department exaggerates the extent of its proactive efforts and improvements in fiscal management. We do not believe that the department's efforts to date have successfully addressed past challenges, to say nothing of the challenges it will face over the next few months and years. As we point out in the report, the department's fiscal management efforts to date have been futile because its efforts were based on spending plan figures that did not align with its spending authority. In addition, although its current fiscal management plans appear adequate, its implementation efforts have been poor. For example, as we discuss in the report, the department fails to always act when its fiscal systems identify potential problems.

2 Although the department believes, as described on page 25 of the report, that it needs an on-line, real-time financial, human resource, and risk management system; we state on page 25, that if the department correctly used systems already in place, it could adequately monitor its fiscal condition and take appropriate action to correct problems. Further, we have recommended a simple reporting system that the department could use to improve its ability to manage its budget without acquiring additional information technology. Moreover, this simple reporting system would assist policy makers in accurately assessing the department's fiscal condition and needs.

3 We acknowledge on page 25 the department's assertion that extensive staff turnover has affected its operations.

4 Our report is not intended to have an adverse affect on staff morale at the department. Instead, it is intended to assist management in fulfilling its responsibility for sound fiscal management. As we state on page 8, the department has a responsibility to ensure that taxpayer funds are spent appropriately and in accordance with the public's mandate and interests.

5 The rationale provided by the department for failing to reconcile its spending plan to its spending authority sooner does not have merit. As the department points out in its response, page 66 of the report, its spending plans should be adjusted throughout the year for changes in its spending authority. Unless the department performs this ongoing alignment, the department's ability to analyze the causes of its deficits will continue to be inadequate.

6 It is not clear to us how these interim measures relate to the fundamental need for the department's divisions and programs to have spending plans that are based upon the department's legislatively approved spending authority.

7 We are deeply concerned about the department's reluctance to report the results of its operations to the Legislature. All of the information to be reported is either already directly available to the department or is easily derived from available data using existing department information technology. As we acknowledge on page 36, preparing the initial report will likely require some additional staff time. However, subsequent reports should not require significant staff resources or time to complete. In addition, this recommendation is based upon much more than the premise the department mentions here. As discussed on page 36, such a report will clarify the causes of any departmental fiscal challenges and allow for resolution during the budgeting process. As noted on page 59, an operations report will also improve the way the department communicates with the Legislature by detailing how the department has spent and plans to spend its funds during the fiscal year. It also shows the relationship between the basis upon which the department requests funding augmentations and how it reallocates its spending authority to meet its spending priorities.

8 This statement is incorrect. Preparing an operations report will not require any reconfiguration of the department's accounting system. The department currently imports its accounting system data into a data analysis system called Monarch. Using this system, the department can easily sort, as we did, the accounting data into the categories we suggest for the operations report.

As the department points out, its monthly budget plan reports do not contain sufficient detail to differentiate categories of projected expenses such as custody versus noncustody salaries and wages. Nevertheless, in developing its projections for salaries and wages, we do not believe it is too arduous to utilize the department's subordinate detail for the projections to differentiate between custody and noncustody staff—three times per year. In addition, as we allude to on page 60 in our report, 14 of the 16 operating expense categories in the department's monthly budget plans are either entirely staff or entirely inmate driven. For the 2 remaining categories, the department will need to allocate its operating expense projections between inmate and staff driven categories using the ratio of actual inmate or staff driven expenditures for each category.

9 The department failed to convince us that the recommended time frames for reporting are unrealistic. Department staff told us that month-end accounting system data is available 15 days after the end of each month. The recommended time frames give the department an additional 30 days to compile the data into the prescribed format and to conduct necessary reviews of the data. Further, the department appears to use our suggestion that it prepare and submit this report as support for its proposed purchase of new information technology. As stated above, all of the information contained in the suggested report is already available or easily derivable from existing resources. In addition, as the department states in its response, page 68 of the report, the existing monthly budget plan system already provides timely assessments that can be used to effectively monitor and control the department's fiscal condition.

10 Although the department claims that it does address problems identified in the monthly budget plan process, as we state on page 23 of the report, for three of the four monthly budget plans we reviewed that projected deficits, the institutions did not submit a corrective action plan. For the one institution that did submit a plan, the plan simply attempted to justify the fiscal position presented and did not suggest any actions to curtail expenditures.

11 In response to the department's concern about a quote from the budget office manager, we revised the text on page 19 to clarify that our quote relates to the Institution and Community Correctional budget managers. Although the department contends that these individuals are supervisors rather than managers, the business cards for both identify them as budget managers.

Moreover, according to State Controller's Office records, both of these individuals are in managerial classifications and are being compensated as managers. Further, we stand by our quote of these managers in the report and are surprised that the department is reporting that these managers are in a training mode. At no time during the audit did anyone mention or did we witness any training of these managers.

12 For the department to now suggest that it is currently implementing this new program comes as a surprise. On several occasions, we asked the department to provide us with evidence of its efforts to control workers' compensation costs and at no time was any such program mentioned.

13 Again, we are surprised by these statements. Despite repeated requests for information regarding the department's efforts to control workers' compensation costs, the department did not provide any evidence for the assertions its makes in its response. In addition, the department spelled out its lack of compliance in a budget change proposal it submitted to the Legislature in December 2000. Specifically, the department requested funding for staff to "begin cost containment efforts" and "to assist in complying with State mandates requiring the department to develop and implement processes and procedures aimed at monitoring and mitigating workers' compensation costs, to maintain the Department Operations Manual, and to develop training modules pertaining to these program areas." Aside from the draft Workers' Compensation Cost Containment Action Plan we mention on page 37 in our report, the department did not provide any other evidence of its actions or plans.

14 Introducing the Employment Development Department (EDD) program here confuses the issue. As we state on page 41 in our report, the Jobs Plus Program and Offender Employment Continuum (Continuum) Program are for parolees who are not quite "job ready." The EDD program is for parolees who are considered "job ready." We also recognize that cheaper is not necessarily better, which is why we also analyzed and supported our conclusion that the Jobs Plus Program is more effective than Continuum with the job placement rates of the two programs on page 41. Further, as we also mention on page 41, according to department staff, the two programs provide similar services with the primary difference being in the workshops provided by the programs. Our recommendation on page 55 acknowledges this difference by stating that the department should

consider changing the Jobs Plus Program workshop to mirror the Continuum workshop if the Continuum workshop is found to be superior.

15 We do not agree with the department that reviewing cost allocation plans for all contracts creates a substantial increase in workload. Our review of the Jobs Plus Program cost allocation plan, which determined that actual billed costs were not fully supported, took only a few minutes. Because our recommendation focuses on only those contracts requiring a cost allocation plan, and not all department contracts, we believe the impact on department resources is not significant in light of the potential for savings.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press