



Medical Board of California:

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

October 2007 Report 2007-038



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Elaine M. Howle
State Auditor
Doug Cordiner
Chief Deputy

CALIFORNIA STATE AUDITOR

Bureau of State Audits

555 Capitol Mall, Suite 300

Sacramento, CA 95814

916.445.0255

916.327.0019 fax

www.bsa.ca.gov

October 16, 2007

2007-038

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 required by the Business and Professions Code, Section 2435, the Bureau of State Audits presents its audit report concerning the Medical Board of California's (medical board) financial status and its projections related to expenses, revenues, and reserves, and the amount of refunds or licensure fee adjustments needed to maintain the reserve level legally mandated for the medical board's contingent fund.

This report concludes that the medical board exceeded the mandated reserve, or fund balance, level by more than 100 percent in fiscal year 2006–07 and, therefore, needs to consider reducing or refunding license fees for physicians and surgeons (physicians). The law requires it to maintain a fund balance that would cover operating expenditures for approximately two months. However, in fiscal year 2006–07, the fund balance grew by \$6.3 million to \$18.5 million, enough to cover 4.3 months of expenditures. This increase was mostly due to variances between actual and estimated expenditures related to program changes.

The deputy director of the medical board recognizes that the fund balance is high, but stated it is too early to take corrective action because the medical board is currently implementing program changes that will increase expenditures. However, based on the medical board's historical experience of overestimating expenditures by at least \$2 million in each of the last four fiscal years, we estimate that the medical board would have 3.8 months of reserves on June 30, 2012.

Respectfully submitted,



ELAINE M. HOWLE
State Auditor

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Summary

Results in Brief

The Medical Board of California (medical board) is a consumer protection agency responsible for protecting the public through the proper licensing and regulation of California's health care professionals and the enforcement of the Medical Practice Act. The medical board accounts for its activities in the contingent fund, its operating fund, which is supported primarily by license fees collected from physicians and surgeons (physicians). Recently, the fund balance in the contingent fund has exceeded the mandated level by more than 100 percent and, therefore, the medical board needs to consider reducing or refunding license fees for physicians. The law requires the medical board to maintain a reserve, or fund balance,¹ that would cover expenditures for approximately two months. For fiscal years 2003–04 through 2005–06, the medical board maintained year-end fund balances that covered 2.4 to 3.3 months of the next year's estimated expenditures. However, in fiscal year 2006–07 the fund balance grew by \$6.3 million to \$18.5 million, enough to cover 4.3 months of expenditures. This increase was due mostly to variances between actual and estimated expenditures resulting from program changes related to the implementation of Senate Bill 231 of the 2005–06 Regular Session of the California Legislature (Chapter 674, Statutes of 2005) and increases in the rates charged by the Office of the Attorney General (Attorney General), which were not fully realized by the end of fiscal year 2006–07.

The medical board's deputy director recognizes that the fund balance is high, but stated it is too early to take corrective action because the medical board must continue to implement the program changes mentioned earlier, so actual costs will closely approach estimates in fiscal year 2007–08. Further, the medical board estimates that months of reserves will drop to 1.5 months by fiscal year 2011–12, assuming that it spends all of its appropriations in each of the next five fiscal years. Our review of employee and Attorney General costs, two of the medical board's largest expenditure categories, indicate that expenditures are increasing somewhat. However, while the medical board's estimated revenues have consistently approximated actual revenues in the last four fiscal years, the medical board has consistently overestimated expenditures by at least \$2 million each year over the same period.

Audit Highlights . . .

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

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

¹ Although the Business and Professions Code refers to a reserve, the medical board and the Department of Consumer Affairs interpret this to mean *fund balance*.

Based on the medical board's future revenue and expenditure estimates, adjusted downward by \$2 million for the expenditure variance we just described, we estimate that the medical board still would have 3.8 months of reserves on June 30, 2012. The medical board's staff is preparing for the November 2007 board meeting at which the medical board will discuss its financial status. Because no other mechanism is in place to reduce the fund balance sufficiently, the board likely will need to issue refunds or seek legislation to allow it to reduce fees.

Recommendations

The medical board should seek a legislative amendment to Section 2435 of the Business and Professions Code to include language that allows it the flexibility to adjust physicians' license fees when necessary to maintain its fund balance at or near the mandated level.

To ensure the fund balance in the medical board's contingent fund does not continue to significantly exceed the level established in law, it should, in light of its future needs, consider refunding physicians' license fees or, if successful in gaining the flexibility to adjust its fees through an amendment to existing law, consider temporarily reducing them.

Agency Comments

The medical board generally agrees with our recommendations and plans to discuss them at its November 2007 board meeting.

Introduction

Background

The Medical Board of California (medical board) is a consumer protection agency responsible for protecting the public through the proper licensing and regulation of California's health care professionals and the enforcement of the Medical Practice Act. Under the Department of Consumer Affairs (Consumer Affairs), it licenses physicians and surgeons (physicians), investigates complaints against its licensees, and disciplines those found guilty of violating the law. It has 21 appointed members—12 physicians and seven public members appointed by the governor, one public member appointed by the speaker of the Assembly, and one public member appointed by the Senate Rules Committee.

The medical board is composed of two divisions—the Division of Licensing and the Division of Medical Quality—and had 275 authorized positions in fiscal year 2006–07, including an executive and a deputy director to oversee its day-to-day operations. The Division of Licensing approves medical education programs, administers physician and surgeon licensure examinations, issues licenses and certificates, and administers the medical board's continuing education program. The Division of Medical Quality investigates complaints, such as those listed in the text box, and disciplines licensees found guilty of violating the Medical Practice Act.

The medical board assesses fees for physicians according to rates and processes established in the California Business and Professions Code (code). The code sets the license fees² at \$790. These fees constituted at least 91 percent of revenues the medical board collected annually for fiscal years 2003–04 through 2005–06. The code also states that the Legislature expects the medical board to maintain a reserve, or fund balance, in its contingent fund equal to approximately

Types of Complaints Investigated by the Medical Board of California

- Inadequate quality of care and treatment provided by a physician.
- Violation of drug laws, such as misprescribing or overprescribing drugs.
- Substance abuse by a physician.
- Sexual misconduct by a physician.
- Dishonesty, including filing fraudulent insurance claims.
- Unlicensed practice of medicine by a person under the supervision of a physician.

Source: Business and Professions Code, sections 2220 and 2264.

² License fees refer to both initial license and renewal fees. The first time a physician applies and pays for a medical license in California, the medical board assesses an initial license fee. The physician must pay a renewal fee every two years to maintain the medical license.

two months of operating expenditures.³ Although the level of the fund balance is established in the code, the medical board does not have the authority to reduce license fees, if needed, to maintain the two-month level.

In 2002 the Legislature passed a law requiring Consumer Affairs to hire an independent consultant to review the medical board's disciplinary system and procedures. The consultant, known as the enforcement monitor (monitor), also examined the medical board's fee structure and concluded in its 2004 report that fees had not kept pace with inflation. On an inflation-adjusted basis, the monitor calculated that the medical board's spending power had dropped by 27.9 percent since the fees were established in 1994. At the time of the monitor's review, license fees were limited to \$600 per year. In 2005 the Legislature passed, and the governor signed, Senate Bill 231 (SB 231), which increased the license fees 31.7 percent, to \$790, effective January 1, 2006.

In 2004 the monitor also recommended, among other things, that the medical board reorganize its process for prosecuting physicians who have had complaints filed against them. Previously, the medical board used what the monitor described as a "hands-off prosecution model." Its investigators received only limited legal support for their investigative work and seldom played a significant role in the prehearing and hearing processes conducted by Attorney General prosecutors, to whom they directed their complaint cases. The monitor pointed out inefficiencies related to this model, citing its inadequacy for handling complex cases of the sort usually handled by the medical board.

The monitor recommended that the medical board instead implement a "vertical prosecution model." Under this model, investigators and prosecutors work together as a team from the day a case is assigned for investigation. The monitor stated that the model would improve efficiency and effectiveness through better communication and coordination, and reduce the time it takes to process cases. The Legislature subsequently required the medical board to establish a vertical prosecution process.

With the passage of SB 231, the Legislature also repealed the medical board's ability to recoup its costs of investigating and prosecuting physicians in disciplinary proceedings brought against them. Before this change, the medical board recovered these costs directly from physicians who violated the law. According to the

³ Although the Business and Professions Code refers to a reserve for the contingent fund, the medical board and the Department of Consumer Affairs interpret this to mean *fund balance*. The contingent fund is the operating fund for the medical board. The Department of Consumer Affairs defines operating expenditures as all expenditures made by the medical board.

legislative analysis of this bill, the California Medical Association requested this change because it believed that cost recovery discouraged physicians from pursuing their due process rights because they chose to settle cases instead of running the risk of bearing the increased costs of an ongoing investigation. Although the medical board cannot collect investigative costs incurred on or after January 1, 2006, directly from physicians, physicians who were assessed recovery costs before January 1, 2006, are still responsible for reimbursement. The law enables the medical board to increase its license fees to compensate for the loss of these reimbursements. Accordingly, the medical board increased fees by 1.9 percent, from \$790 to \$805, effective January 1, 2007.

Scope and Methodology

Section 2435 of the code directs the Bureau of State Audits (bureau) to review the medical board's financial status and its projections related to expenses, revenues, and reserves, and to determine the amount of refunds or licensure fee adjustments needed to maintain the reserve level legally mandated for the medical board's contingent fund. The bureau is to report its findings before January 1, 2008.

To understand the medical board's responsibilities and financial reporting, we reviewed the relevant laws, regulations, and policies. We also spoke with medical board and Consumer Affairs staff members who oversee the medical board's accounting, budgeting, and financial reporting functions.

To determine the medical board's financial status, we reviewed its estimated and actual revenues and expenditures for accuracy, identifying and examining significant variances between years, and between estimated and actual figures, for fiscal years 2003–04 through 2006–07. Additionally, we reviewed the medical board's year-end fund balances to determine if they were reported accurately and approximated two months of expenditures, as mandated by law.

Further, we reviewed the medical board's estimates for fiscal year 2007–08 to identify any significant changes in projected revenues, expenditures, or fund balance for the upcoming year.

The U.S. Government Accountability Office, whose standards we follow, requires us to assess the reliability of computer-processed data. Since we used reports generated from the California State Accounting and Reporting System (CALSTARS), we relied on our testing of revenues and expenditures performed each year during our annual financial audit of the State. In addition, we verified that the revenues and expenditures reported for the medical board

reconciled with similar records at the State Controller's Office. This testing indicated that the data were sufficiently reliable for the purposes of this audit.

Audit Results

The Fund Balance of the Medical Board of California's Contingent Fund Increased Significantly in Fiscal Year 2006–07

The fund balance of the Medical Board of California's (medical board) contingent fund⁴ increased to \$18.5 million in fiscal year 2006–07, resulting in reserves well above mandated levels. It appears that the fund balance will not drop significantly based on its revenue stream and its historical experience in estimating expenditures, so the medical board needs to consider reducing license fees⁵ or issuing a refund to physicians and surgeons (physicians). The Business and Professions Code (code) requires the medical board to maintain a reserve, or fund balance,⁶ that will cover approximately two months of operating expenditures.⁷ The medical board determines its fund balance by adding the difference between the current fiscal year's expenditures and revenues to its beginning fund balance. As the Table shows, the medical board's actual fund balance at the end of fiscal years 2003–04 through 2006–07 ranged from \$8.6 million to \$18.5 million.

Table
Contingent Fund of the Medical Board of California
Actual and Estimated Revenues, Expenditures, and Fund Balance (in Millions)

	FISCAL YEAR 2003–04		FISCAL YEAR 2004–05		FISCAL YEAR 2005–06		FISCAL YEAR 2006–07	
	ESTIMATED	ACTUAL	ESTIMATED	ACTUAL	ESTIMATED	ACTUAL	ESTIMATED	ACTUAL
Adjusted beginning balance*	\$12.8	\$12.4	\$11.3	\$11.4	\$8.6	\$8.8	\$12.2	\$12.8
Total revenues, transfers, and other adjustments	35.3	35.4	36.7	35.5	40.6	41.1	48.7	49.7
Total expenditures and expenditure adjustments	(38.5)	(36.5)	(41.0)	(38.3)	(42.5)	(37.7)	(50.0)	(44.0)
Fund balance	\$9.6	\$11.3	\$7.0	\$8.6	\$6.7	\$12.2	\$10.9	\$18.5
Months of reserves [†]	2.8	3.3	2.0	2.4	1.6	2.9	2.5	4.3

Source: California State Accounting and Reporting System reports for fiscal years 2003–04 through 2006–07 and the Governor's Budget for fiscal years 2004–05 through 2007–08.

Note: The contingent fund is the operating fund for the medical board.

* Beginning balances are adjusted for differences between accruals and actual revenues and expenditures related to prior years.

† This amount is derived by dividing the year-end fund balance by one-twelfth of the subsequent year's estimated annual expenditures. Estimated expenditures for fiscal year 2007–08 were \$51.2 million.

⁴ The contingent fund is the operating fund for the medical board.

⁵ License fees refer to both initial license and renewal fees. The first time a physician applies and pays for a medical license in California, the medical board assesses an initial license fee. The physician must pay a renewal fee every two years to maintain the medical license.

⁶ Although the Business and Professions Code refers to a reserve, the medical board and the Department of Consumer Affairs interpret this to mean *fund balance*.

⁷ The Department of Consumer Affairs defines operating expenditures as all expenditures made by the medical board.

Although actual year-end fund balances between fiscal years 2003–04 and 2005–06 differed as much as \$3.6 million, the differences did not significantly affect the medical board’s months of expenditures (months of reserves), which ranged from 2.4 months to 3.3 months during this period. However, during fiscal year 2006–07, the fund balance grew by \$6.3 million, resulting in an increase in months of reserves to 4.3 months—more than 100 percent above its mandated level.

Provisions Included in Senate Bill 231

- Establish a vertical prosecution model.
- Require the assignment of attorneys to work on location at the intake unit of the Medical Board of California (medical board) to evaluate and screen complaints and develop uniform standards for complaint processing.
- Require the medical board to contract with an outside entity to conduct a study of its peer review process for disciplining physicians.
- Require the Little Hoover Commission to study and make recommendations on the role of public disclosures by the medical board. The medical board is required to reimburse the Little Hoover Commission for these costs.
- Authorize the medical board to cite and fine physicians for not providing requested documents within specified time frames.

Source: Senate Bill 231 of the 2005–06 Regular Session of the California Legislature (Chapter 674, Statutes of 2005).

The increase in the fund balance was caused mostly by the variance between estimated and actual expenditures in fiscal year 2006–07, primarily related to a planned expansion of medical board programs that was not fully realized in that year. The medical board anticipated spending \$7.5 million more in fiscal year 2006–07 than it estimated spending in fiscal year 2005–06, mostly for costs associated with implementing Senate Bill 231 (SB 231) (see text box) and for increases in the Office of the Attorney General’s (Attorney General) rates. Implementation of SB 231 accounted for \$3.9 million of the increased expenditure estimate.

As described in the text box, this legislation required many changes in medical board activities, such as the hiring of additional staff and consultants, as well as implementation of a vertical prosecution model, which requires earlier participation from Attorney General prosecutors. In addition to the increased expenditures necessary for vertical prosecution, estimated expenditures included \$760,000 to cover an increase in the hourly rate the Attorney General charges for its services.

The Fund Balance Likely Will Remain Above Acceptable Levels Unless Fees are Reduced or a Refund Is Issued

Although the effect of several issues that contributed to the buildup of the medical board’s fund balance in fiscal year 2006–07 is diminishing, we believe the fund balance is unlikely to return to the level legally mandated unless fees are reduced or refunded. By the end of fiscal year 2006–07, the medical board had only spent \$44 million, or 88 percent of its estimated budget for that year. The resulting excess in fund balance represents approximately \$88 per licensed physician.

The deputy director of the medical board (deputy director) provided two significant reasons to explain why expenditures fell so far below expectations. First, she noted that staff vacancies, which at any point during the year were at least 24, or 8.7 percent of total authorized positions for fiscal year 2006–07, accounted for \$1.6 million of the unspent appropriation. She attributed about half of the vacancies to the medical board’s difficulty in retaining investigators because of salary inequities and workload issues. Second, the deputy director pointed out that the Attorney General provided only \$11.2 million in services to the medical board, \$1.2 million below estimates. She attributed this variance to three Attorney General vacancies related to new positions authorized under SB 231. The remaining savings were spread among numerous expenditure categories.

The deputy director also stated that, even though the fund balance is higher than the mandated level, she believes it is too early to take corrective action by adjusting fees or issuing a refund to physicians. She stated that it has been challenging to predict how much the medical board will need to spend because it is implementing major program changes, as described earlier. However, the deputy director believes that actual revenues and expenditures in fiscal year 2007–08 will closely approach estimates of \$49.1 million and \$51.2 million, respectively. The medical board further estimates that its months of reserves will fall to 1.5 months by the end of fiscal year 2011–12. This is based on the assumption that it will spend all its appropriations in each of the next five fiscal years. The deputy director also noted that the medical board is in the planning stages for purchasing a new information technology application system supporting all medical board business processes, most specifically the new vertical prosecution model, and reestablishing a program focused on unlicensed activity.

Our review of recent trends in two of the medical board’s largest expenditure categories—employee and Attorney General costs—indicates that some types of expenditures are indeed increasing. Specifically, the Medical Board’s vacancy reports in August show that the number of unfilled staff positions decreased to 18, or 6.5 percent of fiscal year 2007–08 authorized positions. If sustained, this increase in staff would close the prior year’s \$1.6 million gap between actual and estimated personnel costs by at least \$485,000 based on the average cost per position in fiscal year 2006–07.

In addition, invoices issued by the Attorney General showed a steady increase for billed services in fiscal year 2006–07. Monthly invoices increased from an average of \$850,000 for the first quarter to \$1 million for the last quarter of the fiscal year. These

The medical board’s deputy director stated that vacant employee positions and lower Attorney General costs explained much of the variance between actual and estimated expenditures in fiscal year 2006–07.

Based on the medical board's historical experience of overestimating annual expenditures by at least \$2 million over each of the last four fiscal years, we estimate that, when we adjusted for this overage, the medical board will still have 3.8 months of reserves on June 30, 2012.

invoice levels, if maintained in fiscal year 2007–08, would reduce the \$1.2 million variance between estimated and actual Attorney General costs experienced in fiscal year 2006–07 by \$615,000.

Nevertheless, based on our review of the medical board's estimated and actual revenues and expenditures over the last four fiscal years, we believe it is unlikely that it will reduce its fund balance significantly within the next five years. Specifically, as the Table on page 7 clearly shows, the medical board's actual revenues consistently approximated estimated revenues for fiscal years 2003–04 through 2006–07. In fact, the net difference between estimated and actual revenues for the entire four-year period amounted only to about \$400,000. This indicates that the medical board's revenue projections have been fairly accurate.

In contrast, actual expenditures fell below estimates by at least \$2 million every year, with annual variances ranging between \$2 million and \$6 million during that four-year period. This pattern, if it continues, will not reduce the fund balance. Although it is possible for the medical board's projections to occur, we think it is unlikely given its historical experience over the last four fiscal years. In particular, using the medical board's estimated revenues and expenditures for fiscal years 2007–08 through 2011–12, we adjusted expenditures downward by \$2 million each year, the lowest expenditure variance over the last four-year period. With these adjustments, we estimate that the medical board would have 3.8 months of reserves on June 30, 2012. Thus, months of reserves will likely remain above the legally mandated limit unless the medical board reduces fees or issues refunds.

Medical board staff reports the fund balance and months of reserve to its board members quarterly. The deputy director told us that medical board staff is preparing to discuss the increased fund balance at the November 2007 board meeting. The deputy director also told us that the medical board already is considering reducing its fees to compensate for the discontinuance of its Diversion Program in June 2008. This program cost \$1.4 million in fiscal year 2006–07. Although the reduction takes into account the revenue and expenditures of the Diversion Program, it does not consider the general issues we noted earlier. Therefore, because no other mechanism is in place to reduce the fund balance sufficiently, the board likely will need to reduce license fees further or issue refunds. To reduce license fees, the medical board would need to seek legislation giving it the flexibility to reduce fees as needed since the fees are established in law.

Recommendations

The medical board should seek a legislative amendment to Section 2435 of the Business and Professions Code to include language that allows it the flexibility to adjust physicians' license fees when necessary to maintain its fund balance at or near the mandated level.

To ensure the fund balance in the medical board's contingent fund does not continue to significantly exceed the level established in law, it should, in light of its future needs, consider refunding physicians' license fees or, if successful in gaining the flexibility to adjust its fees through an amendment to existing law, consider temporarily reducing them.

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 the report.

Respectfully submitted,



ELAINE M. HOWLE
State Auditor

Date: October 16, 2007

Staff: Jim Sandberg-Larsen, CPA, CPFO, Project Manager
Barbara Henderson, CPA
Andrew Jun Lee
Salvador Sanchez

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State and Consumer Services Agency
915 Capitol Mall, Suite 200
Sacramento, CA 95814

September 27, 2007

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

Dear Ms. Howle:

Thank you for giving me the opportunity to respond to your audit addressing the Medical Board of California's Contingent Fund. I understand that your sample examined the fund's year ending reserve for 2003-04, 2004-05, 2005-06, and 2006-07. The agency notes that the funds' future year end reserve may be affected by future statutes, collective bargaining, and approved budget increases.

Obtaining resources from fees paid by medical doctors, the Contingent Fund supports operations of the Medical Board of California. These operations include licensing medical doctors, investigating complaints, disciplining those who violate the law, and conducting physician evaluations. It also includes facilitating rehabilitation where appropriate.

I have directed the Medical Board to report their revised 2007-08 budget and proposed 2008-09 budgets through the Department of Consumer Affairs in January 2008. I recognize your recommendations as an opportunity to improve the Medical Board and truly appreciate your support of the Department of Consumer Affairs' goals of protecting California's consumers.

Most Sincerely,

(Signed by: Michael Saragosa for)

Rosario Marin, Secretary
State and Consumer Services Agency

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(Agency response provided as text only.)

Medical Board of California—Executive Office
1434 Howe Avenue, Suite 92
Sacramento, CA 95825

September 28, 2007

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

RE: Draft Audit Report 2007-038—Medical Board of California

Dear Ms. Howle:

The Medical Board of California (Board) is in receipt of your draft audit report for the Board's financial status. I would like to thank the Bureau of State Audits for conducting this audit and for allowing the Board to respond to the issues presented in the audit report.

As stated in the audit report, the Board's fund condition was over the recommended level at the end of fiscal year 2006/2007. Based upon this finding, the audit made two recommendations. We would like to respond to each of these.

Recommendation: The Medical Board should seek a legislative amendment to section 2435 of the Business and Professions Code to include language that allows it the flexibility to adjust physicians' license fees when necessary to maintain its fund balance at or near the mandated level.

Response: The Board concurs with this finding. Prior to passage of Senate Bill 231 (Figueroa, Chapter 674, Statutes 2005) (SB 231), the Board had the flexibility of setting a fee within the cap set by law. At that time, this section stated that the licensing and renewal fee "shall be fixed by the Board at an amount not to exceed six hundred ten dollars (\$610)". This authorized the Board to seek regulatory changes, when necessary, to increase or decrease the licensing and renewal fee, as appropriate, and to ensure the Board's fund condition remained near the stated guideline of approximately two months' operating expenditures. However, when SB 231 was passed, it changed section 2435 of the Business and Professions Code to state the initial license and biennial renewal fee "...shall be seven hundred ninety dollars (\$790)". It further authorized an increase to the fees to offset funds because legislative language removed the investigative and prosecutorial cost recovery provision. If the statute were changed to allow the Board to vary its fees via the regulatory process, it would provide more flexibility. Therefore, we concur with this recommendation and will present it to the Board at its November meeting.

* California State Auditor's comment appears on page 19.

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Recommendation: To ensure the fund balance in the Medical Board's contingent fund does not continue to significantly exceed the level established in law, it should, in light of its future needs, consider refunding physicians' license fees or, if successful in gaining the flexibility to adjust its fees through an amendment to existing law, consider temporarily reducing them.

Response: On January 1, 2006, the Board increased its licensing and renewal fees to \$790 as mandated by SB 231. This increase in fees was based upon a report from the Enforcement Monitor that indicated that the Board could not perform the necessary investigative and prosecutorial functions under its current funding and staffing level. This fee was based upon the cost of the new "vertical enforcement-prosecution" (VE-P) program that was to be fully implemented by the transfer of the Board's investigative staff to the Department of Justice (DOJ) and the need, as pointed out by the Enforcement Monitor, to increase investigative staff. The cost of the transfer of positions included the realignment of salaries to those used by DOJ. The bill was amended days before the session ended to make the VE-P program a "pilot program" with the investigative staff remaining with the Board but with added DOJ staff to facilitate the VE-P model without co-location of staff. This amendment included a sunset date with a report due back to the legislature on the recommendations to fully implement the program. A proposal to consider any change in fees could not be undertaken until a decision was made in the 2007 legislative session to fully implement the program, to extend the pilot, or to sunset the program. No matter the outcome of the VE-P program, the Board has given direction to staff to pursue avenues to affect the recommendation to align the salaries of the investigators working in the VE-P program with the salaries of investigators at DOJ.

The Board would like to provide some historical data regarding its fund condition. After the Enforcement Monitor's initial report and prior to SB 231 (increase of fees), the Board proposed reestablishing the unlicensed activity unit that was lost during the vacancy sweep in FYs 2001/2002 and 2002/2003. However, the Board was unable to pursue this course of action due to the decreasing fund balance.

Enforcement staff is again discussing the need for this unlicensed activity unit. This unit would investigate all unlicensed complaints and perform undercover investigations at facilities (or homes) of individuals who are performing the unlicensed practice of medicine. Recent meetings pursuant to SB 1423 (Figueroa, Chapter 873, Statutes of 2006) have increased the staff's awareness of unlicensed activity. Therefore, a request will be brought forward to the Board in November to reestablish this unit with both a Northern and Southern California office through a request for a budget change proposal (BCP).

In addition, at the past July Board meeting, the Board members stated their intention to have the Board's computer applications and systems capable of interacting with the DOJ computer system. Upon this direction, staff has met with the DOJ to determine the feasibility of pursuing this action. The Board will be purchasing and implementing a new information technology application system to implement this request.

Furthermore, the Board will be implementing its new Strategic Plan. After this plan is adopted, it is expected that new programs will need to be implemented to meet the goals of the Board and its mandate of public protection. The cost is undetermined at this time.

- ① If the Board receives authorization to pursue these program changes (through BCP), it will significantly increase the Board's current expenditures and will cause a reduction in the current fund balance. This would bring the fund balance closer to two months' operating expenditures. Thus, immediate action related to changing the amount of the fees would not be prudent at this time.

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Finally, the audit report pointed out that in FY 2006/2007 the Board's estimated expenditures were significantly different than the actual expenditures. The report pointed out this was related to the fact the Board was not able to fully implement planned programs. FY 2006/2007 was also the first complete fiscal year with the new fees and the first complete year of implementation of the VE-P pilot program. It is important to recognize that when completing current year projections for the Board's budget, staff reviews expenditures already incurred for the fiscal year at a given point in time, and uses that information, as well as additional information, to estimate how much will actually be spent by the end of that fiscal year. This projection is used to monitor the Board's current year budget to ensure that it does not exceed its authorized expenditure authority. In contrast, when putting together the Board's official fund condition used in the Governor's Budget, Department of Finance requires programs to assume that budgeted expenditures will be fully spent, starting in the current year, as the program is authorized to spend up to its budgeted amount. A fund condition is then used to monitor the fund reserve, to ensure the fund is expected to receive revenue sufficient to support its budgeted expenditures and remain within applicable statutory limitations.

When the Board reviews these matters to determine how to proceed, it will keep in mind that the control agencies want to see several years of fund balance projections, **beginning with budget year**, to make sure the Board can support its expected budget authority, including BCPs. The control agencies also look at whether the Board will be able to show fiscal solvency five to ten years beyond implementation. Standard budget practices use the budget year as the appropriate point in time to review the fund condition and determine the status of the reserve. This ensures that if the prior year expenditures were just an anomaly, the Board will not make a long-term decision about revenue based upon experience in just one year.

Additionally, when control agencies review fund conditions to determine if they are in compliance with statutory limitations, they look at what the reserve amount will be at the end of budget year, not current or prior year. For the Board, the statutory limitation is set at approximately two months' operating expenditures. A reserve ceiling of only two months, in comparison to other Department of Consumer Affairs boards/bureaus, is significantly low. Most other boards/bureaus are required to maintain no more than a 24 month reserve.

Based upon all these factors, the Board agrees this issue must be discussed at the November 2007 Board meeting. The recommendations of this audit as well as the items above will be discussed to determine the appropriate course of action for the Board to take at this time. In addition, staff will request that the Board approve a legislative proposal for 2008 that would allow the Board the flexibility it needs as recommended in the audit report.

The Board appreciates the opportunity to respond to these recommendations and hopes this additional information is explanatory of the Board's future actions. If you have any questions regarding this response, please contact me at (916) 263-2389.

Sincerely,

(Signed by: Barb Johnston)

Barb Johnston
Executive Director

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COMMENT

CALIFORNIA STATE AUDITOR'S COMMENT ON THE RESPONSE FROM THE MEDICAL BOARD OF CALIFORNIA

To provide clarity and perspective, we are commenting on the Medical Board of California's (medical board) response to our audit. The number below corresponds to the number we have placed in its response.

We agree that the medical board should consider the extent to which increased expenditures for new programs and projects could help reduce the fund balance in its contingent fund. However, given the lack of financial estimates related to these plans and the extent to which actual expenditures have historically fallen below estimated expenditures, the medical board should also consider adjusting or refunding fees as stated in our recommendation.

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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