



State Mandates:

Operational and Structural Changes Have Yielded Limited Improvements in Expediting Processes and in Controlling Costs and Liabilities

October 2009 Report 2009-501



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October 15, 2009

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

Dear Governor and Legislative Leaders:

Under its authority to perform follow-up audits and those addressing areas of high risk, the California State Auditor presents its audit report concerning state mandate determination and payment processes.

This report concludes that while the Commission on State Mandates (Commission) has made progress in reducing its backlog of test claims for state mandates, the continuing backlog is large and includes many items from 2003 or earlier. This situation, combined with the long time that elapses before the Commission makes determinations, means that substantial costs will continue to build before the Legislature has the information it needs to take any necessary action. In addition, cost estimates at the time the Legislature considers a potential mandate are inherently difficult to develop. This situation underscores the need for the Commission to more quickly complete the test claim process and develop a statewide cost estimate, which is the first accurate measure of what a mandate will actually cost the State.

The State Controller's Office (Controller) appropriately oversees mandate claims, but the continuing high level of its audit adjustments indicates that the State could save more money if the Controller were able to fill vacant audit positions. In addition, largely because of insufficient funding, the State's liability related to state mandates grew to \$2.6 billion in June 2008 and is likely to continue to climb. Further, participants in the mandate process have rarely used recently established options that could relieve the Commission of some of its workload, and a recent court case has taken away the Legislature's ability to direct the Commission to reconsider its decisions in light of changes to the law. For all of these reasons, additional reform proposals put forward by the Department of Finance, the Legislative Analyst's Office, and local entities merit further discussion. Finally, we have added the areas of mandate determination and payment to the list of high-risk issues we continue to monitor.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

Over the last six years, since we issued our last report on state mandates,¹ operational and structural changes have marginally improved the way state mandates are determined and subsequently managed in California. However, long delays and a growing liability indicate the need for further changes. Reimbursable costs for the mandate activities that local entities performed during fiscal years 2003–04 through 2007–08 were significant, averaging \$482 million annually. A test claim from a local entity, such as a local governmental agency or a school district, begins the process for the Commission on State Mandates (Commission) to determine whether a mandate exists. Although the Commission has made progress in reducing its backlog of test claims over the last six years, the continuing backlog is large. In fact, many test claims from 2003 or earlier are still outstanding. This circumstance, combined with the long time elapsed before the Commission makes determinations, means that substantial costs will continue to build up before the Legislature has the information it needs to take any necessary action. In addition, cost estimates at the time the Legislature considers a potential mandate are inherently difficult to develop. This situation underscores the need for the Commission to more quickly complete the test claim process and develop a statewide cost estimate, which is the first accurate measure of what a mandate will actually cost the State. Finally, the Commission's backlog of incorrect reduction claims, which local entities file when they believe their claims for payment have been inappropriately cut by the State Controller's Office (Controller), has significantly increased.

The Controller uses a risk-based system for selecting claims to audit, has improved its process by auditing claims earlier than in the past, has sought parameter and guideline amendments to resolve identified claiming issues, and has undertaken outreach activities. Nevertheless, the continuing high level of audit adjustments for some programs indicates that the State could save more money if the Controller were able to fill 10 vacant audit positions. In addition, the Commission's lack of action on incorrect reduction claims has hindered the Controller's efforts to implement clear and consistent policies related to cost reimbursement. This has created uncertainty about what constitutes a proper claim. Finally, largely because of insufficient funding, the State's liability related to state mandates

Audit Highlights . . .

Our review of state mandate determination and payment processes found that:

- » *The Commission on State Mandates (Commission) still has a large backlog of test claims, including many claims from 2003 or earlier.*
- » *The high level of audit adjustments for some mandates suggests that the State could save more money if the State Controller's Office were able to fill 10 vacant audit positions.*
- » *The Commission's backlog of incorrect reduction claims has significantly increased and creates uncertainty about what constitutes a proper claim.*
- » *The State's liability for state mandates has grown to \$2.6 billion in June 2008, largely because of insufficient funding.*
- » *Recent reforms that could relieve the Commission of some of its workload have rarely been used.*
- » *A number of state and local entities have proposed mandate reforms that merit further discussion.*

¹ State mandates are new programs or higher levels of service required of local entities by the State. The State is required to provide funding to reimburse local entities for their associated costs.

grew to \$2.6 billion in June 2008. Consequently, the ongoing need to pay for past mandate activities is likely to affect adversely the State's spending on other priorities in the future.

Legislation affecting the structure of the state mandate system has had limited results. Participants in the mandate process rarely use options that could relieve the Commission of some of its workload, and when the options are unsuccessful they can lengthen processing times. However, these options have been available for less than two years, and the State has done little to publicize them. In addition, a recent court case has taken away the Legislature's ability to direct the Commission to reconsider its decisions in light of changes to the law. Although this avenue is now barred, a process that ensures mandate determinations are revised when appropriate is necessary. Commission staff said that in April 2009 a legislative subcommittee directed the Department of Finance (Finance), the Legislative Analyst's Office (Legislative Analyst), and Commission and legislative staff to form a working group to develop legislation to establish a mandate reconsideration process consistent with the court decision. Finance, the Legislative Analyst, and local entities have proposed other mandate reforms including ones focused on problems related to initial cost estimates and delays in mandate funding. Reform proposals merit further discussion, given the significance of the costs associated with state mandates.

Our assessment of current state mandate issues has led us to add the areas of mandate determination and payment to our list of high-risk issues. To the extent that resources are available, we will continue to monitor the progress of the Commission in reducing its work backlog, the level of the State's liability, and the status of recent and future reforms intended to improve the mandate process.

Recommendations

To ensure that it sufficiently resolves its backlog of test claims and incorrect reduction claims, the Commission should work with Finance to seek additional resources to reduce its backlog of work. In doing so, the Commission should prioritize and seek efficiencies to the extent possible.

To ensure that it can meet its responsibilities, including a heightened focus on audits of state mandates, the Controller should work with Finance to obtain sufficient resources. Additionally, the Controller should increase its efforts to fill vacant positions that can be used for auditing mandate claims.

To promote alternative processes related to establishing and claiming costs under mandates, the Commission and Finance should make information about these alternatives readily available to local entities on their Web sites.

To establish a reconsideration process that will allow mandates to be revised when appropriate, Commission staff should continue their efforts to work with the legislative subcommittee and other relevant parties.

To improve the state mandate process, the Legislature, in conjunction with relevant state agencies and local entities, should ensure the further discussion of reforms.

Agency Comments

The agencies we reviewed agree with our recommendations and plan to take steps to implement them.

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Introduction

Background

The California Constitution requires that whenever the Legislature or any state agency mandates a new program or higher level of service for a local entity, the State is required to provide funding to reimburse the associated costs, with certain exceptions. The California Supreme Court defined a new program or higher level of service as one that carries out the governmental function of providing a service to the public, or laws that, to implement a state policy, impose unique requirements on local entities and do not apply generally to all residents and entities in the State. The Commission on State Mandates (Commission), two other state agencies, and local entities are the key participants in California's state mandate process.

The Commission is a seven-member group consisting of the state controller, the state treasurer, the director of the Department of Finance (Finance), the director of the Office of Planning and Research, as well as one public member and two local entity members appointed by the governor. It is a quasi-judicial body whose primary responsibility is to hear and decide if test claims filed by local entities identify mandates for which the State is required to reimburse costs. A test claim is the first claim filed with the Commission alleging that a certain law imposed state mandated costs.

As a quasi-judicial body, the Commission's role is similar to a court's in that it deliberates in a formal manner by considering evidence and hearing testimony from local entities, state agencies, and other interested parties. The courts have found that in establishing the Commission, the Legislature intended to create an administrative forum for resolution of assertions of state mandates with procedures designed to avoid multiple proceedings, whether judicial or administrative, addressing the same alleged mandates. Like a court, the Commission does not initiate claims or actions but rules only on issues brought before it. For example, when the State enacts a law, the Commission does not evaluate the law to determine whether a state mandated local program exists until a local entity files a test claim asserting that the law imposes a mandate. In addition, the Commission adjudicates incorrect reduction claims, which local entities file when they believe their claims for payment have been inappropriately cut by the State Controller's Office (Controller).

The Controller has the role in the mandate process of issuing claiming instructions in accordance with the parameters and guidelines (guidelines) issued by the Commission, processing and

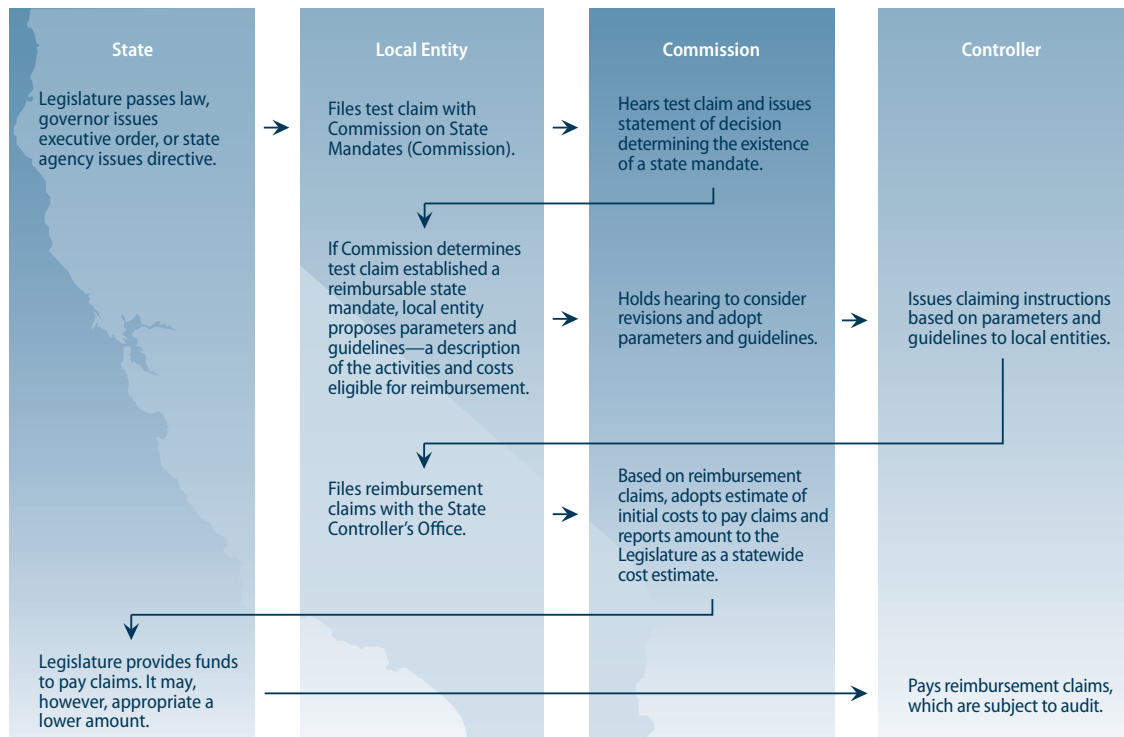
issuing payments on mandate claims, and performing audits of select mandate claims to ensure they abide by the Commission's guidelines. The Legislative Counsel reviews pending legislation to determine whether it believes a reimbursable state mandate would result; if so, Finance creates an initial estimate of costs associated with the proposed legislation. In addition, Finance may work with local entities in two new mandate processes—the jointly developed reasonable reimbursement methodology and legislatively determined mandate processes—which became effective in January 2008 and are discussed further in Chapter 3.

Local entities include educational entities, which are either school districts or community college districts, and local agencies, such as California cities and counties. State law requires a local entity to submit a test claim to the Commission within 12 months of the effective date of, or from incurring increased costs as a result of, new legislation or an executive order. The test claim asserts that the law requires a new program or higher level of service for local entities and that the program or service should therefore be a reimbursable mandate. If the Commission approves the test claim, the local entity submits proposed guidelines specifying which activities and costs are reimbursable. Also, local entities submit annual mandate claims to the Controller for state reimbursement.

State law sets a 12-month time frame for the processing of test claims and the adopting of statewide cost estimates. The law, however, allows the Commission to grant postponements of hearings and extensions for submitting comments. As Figure 1 shows, the process for determining whether a state mandate exists begins after a requirement has been imposed and a local entity submits a test claim alleging that a new program or higher level of service has been mandated and that the local entity has incurred new costs as a result. If the Commission determines that the test claim establishes the existence of costs mandated by the State, the Commission issues a statement of decision, which is legally binding and formally indicates that a state mandate exists. Then the Commission must adopt guidelines for claiming reimbursement of such costs. The guidelines must describe the activities and costs that are eligible for reimbursement and, if necessary, provide directions on how to calculate certain costs.

Although the law requires the Commission to adopt guidelines, the local entity filing the test claim is designated by statute to submit the proposed content of those guidelines. Most importantly, the guidelines must comply with the Commission's statement of decision. The Commission's regulations also require that the guidelines include a summary of the new program or higher level of service required by the State. The guidelines are also to include a

Figure 1
Reimbursement Process for New State Mandates



Sources: The Commission’s mandate determination process brochure as well as state law and regulations.

Note: The process described above is that followed for the vast majority of state mandates. Recent legislation offers alternative processes that have been used a few times since their establishment in 2008. In Chapter 3 we discuss the limited success these alternatives have experienced through August 2009.

description of the most reasonable methods of complying with the mandate. State representatives are included on mailing lists to receive comments and analyses related to key documents, such as the statement of decision and the guidelines, and may participate extensively in the process. For example, Finance and the Controller routinely provide comments on the test claims and the guidelines for mandates. In addition, representatives of local entities and their consultants are included on mailing lists and also participate in the commenting process. Following a review of all submissions, Commission staff prepare proposed guidelines for presentation at a Commission hearing. In the final proposed guidelines, staff recommend adoption of the local entity’s proposed guidelines as originally submitted or modified.

State law requires that once the Commission adopts guidelines, it must send them to the Controller. Within 60 days, the Controller must issue claiming instructions to local entities based on the reimbursable activities described within the guidelines.

Local entities have 120 days from the issuance of the claiming instructions to file reimbursement claims with the Controller. They can employ consultants to assist them in preparing their claims. Claims are subject to the initiation of an audit by the Controller no later than three years after the date the actual claim is filed or last amended, whichever is later, unless no funds have been appropriated or no payment has been made to a local entity. In that event, the three-year period begins on the day the initial payment is made.

State law also requires the Commission to adopt a statewide cost estimate, which can cover multiple years and is based on claims filed by local entities. The Commission submits the statewide cost estimate to the Legislature as part of its periodic report on new mandates. The Legislature uses this report to make funding decisions regarding the initial costs of new mandates.

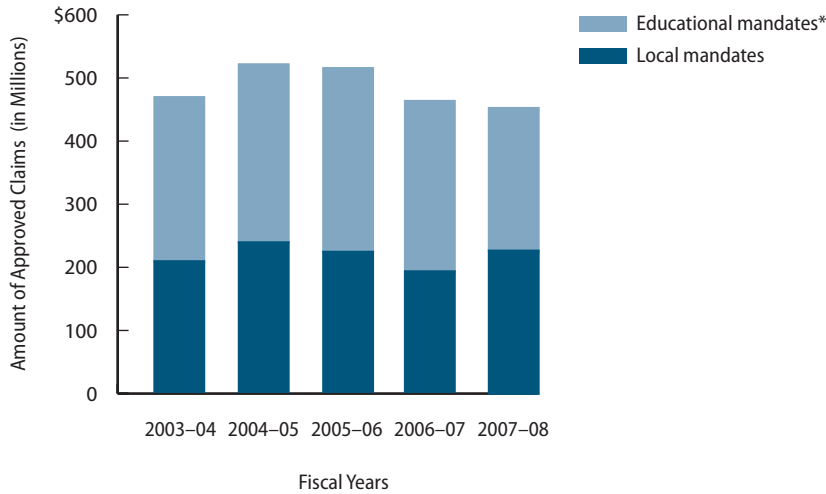
The Controller is required to present data annually to Finance and legislative committees regarding the funding status of all mandates for which the Legislature previously has appropriated funds. This report particularly emphasizes the funding shortfall, referred to as a deficiency, between mandate claims presented by local entities and funds the Legislature has appropriated to pay these claims.

The process described here is the one followed for the vast majority of state mandates. More recent legislation offers alternative processes that have been used a few times since their establishment in 2008. In Chapter 3 we discuss the limited success these alternatives have experienced through August 2009.

State Mandate Claims and Appropriations

For state mandate activities undertaken between fiscal years 2003–04 and 2007–08, the Controller approved, on average, \$482 million in claims per year. As displayed in Figure 2, the total claims that the Controller approved rose from \$466 million in fiscal year 2003–04 to a high of \$518 million in fiscal year 2004–05. However, in the three following fiscal years, approved claims decreased, and in fiscal year 2007–08 they totaled only \$452 million. The drop in claims is partly the result of eliminated mandates. We further discuss this issue in Chapter 2. Because in accordance with state law, the Controller will accept late claims for fiscal year 2007–08 until February 2010, the related amounts for that year in Figure 2 may be somewhat understated. Additionally, because of a recent legal change, local entities no longer submit estimated claims, only filing actual claims by February following the end of the previous fiscal year. Therefore, comprehensive claims data for fiscal year 2008–09 will not be available until February 2010.

Figure 2
Approved Mandate Claims
Fiscal Years 2003–04 Through 2007–08



Source: State Controller’s Office data on mandate claims.

* Of the approved educational claims for the five fiscal years, 86 percent relate to school districts; the remaining 14 percent relate to community college districts.

Claims for mandated programs fall into two categories: claims from educational mandates and claims from local mandates. Educational mandates spring from legislation relating to community colleges and to primary and secondary schools. Local mandates relate to legislation requiring services relating to a myriad of issues, including domestic violence and absentee voting. Educational mandates comprised 55 percent of total approved claims for mandated activities undertaken between fiscal years 2003–04 and 2007–08.

For this same period, the Controller approved claims for more than 120 different mandates totaling \$2.4 billion. However, the largest 12 mandates accounted for 67 percent of all approved claims and represented 61 percent of the state mandate liability outstanding at June 30, 2008. Of those 12 mandates, six are educational and six are local. See Table 1 on the following page for further information on these high-dollar-amount mandates.

State law says that if the Legislature specifies that it will not provide reimbursement for a mandate in a particular year, local entities need not carry out the mandate activities. This process is referred to as *mandate suspension*. While a mandate is suspended, local entities are not required to undertake activities stipulated in the law and are not eligible for reimbursement if they do. If the Legislature

Table 1
Mandates With the Highest Total Approved Claims
Fiscal Years 2003–04 Through 2007–08
(Dollars in Millions)

MANDATE NAME	MANDATE TYPE	YEAR COMMISSION ON STATE MANDATES DETERMINED PROGRAM TO BE A MANDATE	TOTAL APPROVED CLAIMS FOR FISCAL YEARS 2003–04 THROUGH 2007–08	TOTAL OUTSTANDING LIABILITY AS OF JUNE 30, 2008
Educational Mandates				
Enrollment Fee Collection and Waivers	Community College	2003	\$95.2	\$169.4
Graduation Requirements	School	1987	341.7	262.7
Collective Bargaining	School	1970s	136.8	56.3
The Stull Act*	School	2004	104.3	177.0
Notification of Truancy	School	1984	65.4	40.9
Mandate Reimbursement Process	School	1986	49.9	16.8
Subtotals			\$793.3	\$723.1
Local Mandates				
Handicapped and Disabled Students I and II, and Seriously Emotionally Disturbed Pupils	Local	1990, 2005, 2000	\$405.0	\$467.3
Absentee Ballots	Local	2003	97.6	49.7
Peace Officers Procedural Bill of Rights	Local	1999	92.1	162.6
Animal Adoption	Local	2001	91.2	65.3
Child Abduction and Recovery	Local	1979	67.2	45.9
Sexually Violent Predators	Local	1998	65.6	42.6
Subtotals			\$818.7	\$833.4
Totals for 12 Largest Mandates			\$1,612.0	\$1,556.5
Totals for All Mandates[†]			\$2,409.2	\$2,556.3
Percentages of Totals for 12 Largest Mandates Compared to Totals for All Mandates			66.9%	60.9%

Sources: State Controller's Office data on mandate claims and liabilities, reports by the Commission on State Mandates (Commission) to the Legislature on approved claims, and Commission staff.

* The Stull Act imposes requirements on school districts to perform increased evaluations of their staff.

† The outstanding liability for the individual mandates shown above does not include interest; instead, interest is included in the liability total for all mandates. Liabilities may include claims for mandate activities that local entities performed before fiscal year 2003–04.

deletes funding for a mandate but does not specifically identify the mandate as suspended, state law says that local entities may seek a court order declaring the mandate unenforceable.

Due to its fiscal difficulties, the State has not completely funded mandates it has not suspended, thus deferring mandate reimbursements. For example, the State owes local agencies \$931 million for mandate activities they undertook before fiscal year 2004–05. Additionally, in recent years, the State has appropriated \$1,000 a year for each of the ongoing educational mandates for school districts. These appropriations totaled \$36,000 for fiscal year 2007–08. A recent court decision noted

that this amounted to only \$1 per district for each mandate in fiscal year 2007–08 and ruled the practice unconstitutional. Because the Legislature has not completely funded local and educational mandates, the amount of unpaid claims, and the interest associated with them, climbed to \$2.6 billion as of June 30, 2008. We further discuss the outstanding mandate liability in Chapter 2.

Previous Audits of State Mandates

During a prior audit of a state mandate, the Bureau of State Audits (bureau) found that the School Bus Safety II mandate cost substantially more than the \$1 million annual cost anticipated when the Legislature passed the law that led to the mandate. We reported this finding in *School Bus Safety II: State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected*, Report 2001-120, March 2002. The Commission reported in January 2001 an estimated annual cost of \$67 million for fiscal year 2001–02. The costs actually claimed varied significantly depending upon the approach taken by the consultants who assisted school districts in claiming reimbursement. We determined that the different approaches appeared to result from a lack of clarity in guidance adopted by the Commission. Of the more than \$2.3 million in direct costs claimed by the seven school districts for fiscal year 1999–2000, we could trace only about \$606,000 to documents that sufficiently quantified the costs. Since the issuance of our report, the School Bus Safety II mandate has been repealed; however, the Commission has implemented various recommendations, such as ensuring that all state departments and legislative fiscal committees have the opportunity to participate in the test claim and guideline process to ensure representation of the State's interests.

In October 2003 the bureau issued an additional audit report on state mandates titled *State Mandates: The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process*, Report 2003-106. The report's findings showed that claimed costs for the Peace Officers Procedural Bill of Rights (Peace Officer Rights) and Animal Adoption mandates were higher than expected, and a significant amount of the costs we reviewed were questionable. In our review of select local entities' Peace Officer Rights mandate claims, we identified as questionable \$16.2 million of the \$19.1 million in direct costs that four local entities claimed for fiscal year 2001–02 because the entities included activities that far exceeded the Commission's intent. Through our review of select Animal Adoption claims, we found that local entities could not sufficiently support staff time spent on the mandate's activities and that one local entity could not adequately separate the reimbursable and nonreimbursable costs incurred for acquiring additional shelter space.

Also within the October 2003 report, we recommended that the Legislature direct the Commission to amend the Animal Adoption guidelines to correct the formula for determining the reimbursable portion of using or constructing additional shelter space. For the Peace Officer Rights mandate, we recommended that the Controller audit claims already paid and request that the Commission amend the guidelines to address any concerns it identified. We discuss the status of certain recommendations that affect multiple mandates in the body of this report and present the overall status of recommendations related to the two previous reports in the Appendix.

Scope and Methodology

The bureau examined the state mandates process under its authority to conduct both follow-up audits and those addressing areas of high risk. To follow up on our prior audits, we reviewed the status of the Commission's work backlogs, including test claims, and assessed how processing times had changed over the years. We also assessed whether the Commission more accurately estimated statewide costs and better disclosed support for them since our last audit. Further, we reviewed the Controller's efforts for using audits to identify and resolve problems in state mandate claims. We also evaluated how the State's mandate liability had changed from June 2004 to June 2008. Further, we assessed the effect of recent structural changes on the state mandate process and summarized possible ways to accomplish the process more effectively. Finally, we reported on the status of recommendations we issued in our 2002 and 2003 reports on state mandates.

Additionally, California Government Code, Section 8546.5, authorizes the bureau to establish an audit program for identifying state agencies that are at high risk for potential waste, fraud, abuse, and mismanagement or that have major challenges associated with their economy, efficiency, or effectiveness. This statute includes challenges that cut across programs or management functions at all state agencies or multiple state agencies. The considerations used for determining high risk are set forth in the Appendix to the inaugural high-risk list published in the bureau's report titled *High Risk: The California State Auditor's Initial Assessment of High-Risk Issues the State and Select State Agencies Face*, Report 2006-601, May 2007. We considered these criteria when deciding whether to add the areas of mandate determination and payment to the bureau's list of high-risk areas.

To understand the Commission's responsibilities, we reviewed applicable laws, regulations, and procedures, and we interviewed Commission staff. We analyzed the Commission's work backlogs,

including test claims and incorrect reduction claims, for December 2003 through June 2009, using reports the Commission periodically provides to the Legislature. We reviewed the timeliness of its test claim decisions by comparing the dates of test claim submissions and completions. Our examination of work backlogs and processing times caused us to consider the Commission's staffing over the period. We identified the Commission's authorized and filled positions by using the annual *Salaries and Wages Supplement* issued by Finance and other data provided by the Commission. Additionally, we evaluated the accuracy of statewide cost estimates for five mandates (the two highest-cost mandates each for local agencies and school districts plus the highest-cost mandate for community colleges) reported since January 2004 by comparing the estimates to actual claims approved by the Controller. To gauge the accuracy of initial cost estimates associated with the laws that underlie mandates, which are developed much earlier than the Commission's statewide cost estimates, we interviewed Finance staff and identified amounts in fiscal analyses for the five mandates. The related legislative bills originated many years ago—ranging from 1985 through 1999. In some cases, Finance and California State Archives staff were unable to provide us with such analyses. In these cases, we looked for other evidence in the legislative record indicating the existence of mandates.

To understand the Controller's responsibilities and authority for processing and auditing mandate claims, we reviewed the applicable laws, regulations, and procedures and interviewed Controller staff. We examined the Controller's processes for conducting desk reviews, which are high-level reviews, as well as field audits, which are detailed reviews examining source documentation. During our evaluation of field audits, we examined the Controller's methods for identifying high-risk claims to audit and the results of its audits. Also, we reviewed the Controller's requests to amend guidelines and its efforts to communicate reoccurring claiming issues to local entities in order to assess whether the Controller takes appropriate actions to resolve problems identified in its audits. We also analyzed fluctuations in the State's accumulated unpaid mandate claims and assessed its success in reducing its mandate liability.

We selected specific mandate programs for highlighted review throughout our analysis. These high-cost mandates included Animal Adoption; Enrollment Fee Collection and Waivers; Graduation Requirements; Handicapped and Disabled Students I and II, and Seriously Emotionally Disturbed Pupils; Standardized Testing and Reporting (subsequently revised to National Norm-Referenced Achievement Test); Peace Officer Rights; and the Stull Act. We used these mandates to focus certain evaluations, such as our review of the Controller's field-audit adjustments and its audit coverage of approved claims submitted. In addition, the

School Bus Safety II mandate was the subject of our 2002 audit; however, in 2004 this mandate was repealed. We discuss the School Bus Safety II mandate further in the Appendix.

To evaluate recent structural changes in the state mandate system, we interviewed staff from the Commission, the Controller, Finance, and the Legislative Analyst's Office (Legislative Analyst); mandate consultants; and local representatives. To identify possible future reforms, we analyzed reform proposals put forward by the Legislative Analyst and Finance during the course of their normal duties. Additionally, we reviewed a 2006 report issued by the Center for Collaborative Policy (Center) at the Commission's request. The Center, a unit of the College of Social Sciences and Interdisciplinary Studies at California State University, Sacramento, assessed the feasibility of using a collaborative process to develop recommendations for reform of California's state mandate process. The Center's report stated that the assessment used best practices and included interviewing a sample of representatives from agencies and organizations most concerned with the process. We also obtained information on state mandate processes in other states through requests for information to the National Conference of State Legislatures and the National Association of State Auditors, Comptrollers, and Treasurers.

To report on the status of recommendations in our 2002 and 2003 reports on state mandates, we summarized the findings and recommendations from the annual status reports we provided to legislative subcommittees in 2004 and 2005, respectively. We considered the information from the agencies' responses contained in those reports, and we updated it as appropriate using information we obtained during this audit.

Chapter 1

THE COMMISSION ON STATE MANDATES STILL HAS LENGTHY PROCESSING TIMES AND LARGE BACKLOGS

Chapter Summary

Over the last six years, the state mandate process has improved only marginally, and continuing lengthy delays indicate the need for further changes. The Legislature creates a potential mandate when it enacts a law that requires local entities to perform a new program or to perform at a higher level of service for an existing program. A test claim from a local entity begins the process for the Commission on State Mandates (Commission) to determine whether a mandate exists. The test claim process is plagued with a still-large, though decreasing, backlog of test claims. As a result, many test claims from 2003 or earlier are still outstanding. This circumstance, combined with the long time that elapses before the Commission makes its determinations, means that substantial costs will continue to build up before the Legislature has the information it needs to take any necessary action. Likewise, the slow process leaves local entities without guidance in determining reimbursable activities and holds them responsible for performing mandated activities without proper funding.

In addition, the inherent difficulty of developing cost estimates at the time the Legislature considers a potential mandate underscores the need to address the Commission's test claim backlog so that the Legislature can act more quickly if needed. The Commission has properly disclosed and improved the accuracy of its statewide cost estimates, which occur much later in the process after local entities begin submitting claims for reimbursement. However, the Commission's backlog of incorrect reduction claims, which local entities file when they believe their claims for payment have been wrongly cut, has increased significantly.

The Commission's Backlog of Test Claims Continues to Be a Problem

The Commission has made progress in reducing its backlog of test claims, but a large number of older claims remains outstanding. Consistent with state law, the Commission has regulations establishing a timeline of one year, subject to extensions, to complete test claims through the identification of a statewide cost estimate, which determines how much initial funding is necessary. However, since 2003, six years have elapsed on average between the submission of test claims and the Commission's publication of the estimate. This statewide cost estimate can cover multiple

By June 2009 the Commission's backlog dropped to 81, but 61 test claims filed before December 2003 are still pending.

years and is based primarily on actual costs. The Commission has had difficulty filling all of its authorized positions, and some have been eliminated, limiting its ability to address backlogged items.

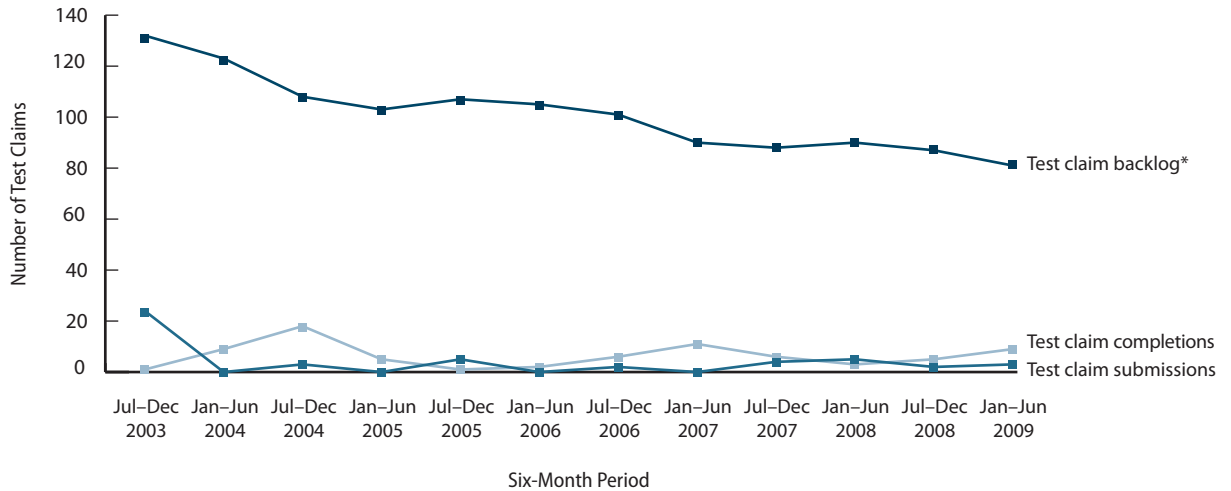
Despite Progress in Reducing Its Test Claim Backlog, the Commission Still Has Not Processed Many Claims From 2003 or Earlier

Although the Commission's test claim backlog dropped from 132 in December 2003 to 81 in June 2009, 61 test claims filed before December 2003 are still pending.² According to Commission staff, Chapter 1124, Statutes of 2002 (Assembly Bill 3000), imposed a statute of limitations for filing test claims that resulted in a 70 percent increase in the number of claims submitted during fiscal year 2002–03 over the number submitted during the previous fiscal year. The statute of limitations required that local entities file test claims within three years following the effective date of the related requirement. For requirements effective before January 2002, the time limit was one year from September 30, 2002, the date the new law was enacted. Figure 3 shows test claim submissions and completions from July 2003 through June 2009, as well as the related backlog at the end of each six-month period. Of particular note is its display of the more than 20 test claim submissions during the last half of 2003. However, the Commission subsequently experienced a decrease in the number of test claims submitted, an occurrence that helped to facilitate the backlog reduction. Additionally, effective in 2005, the Legislature reduced the existing statute of limitations for filing new test claims from three years to one year. This reduction appears to have contributed to a decline in subsequent submissions as no more than five new test claims have been submitted per six-month period since January 2005.

For one six-month period—July through December 2004—as staffing and workload priorities allowed, the Commission was able to adopt a statewide cost estimate for 18 test claims, thus completing its process. Nonetheless, 61 of the 81 test claims in the backlog as of June 2009 remain from 2003 or earlier. Of the 81 test claims, 58 were still awaiting mandate determination. Commission staff cite several reasons for the aged backlog, including reductions to the Commission's authorized positions and budget and the prioritization of legislative directives to reconsider 13 of its past mandate decisions. Between fiscal years 2003–04 and 2006–07, the Legislature directed the Commission to reconsider past mandate

² For purposes of our analysis, we considered that test claims were completed and left the backlog in one of three ways: (1) Test claims determined to be mandates were considered complete once a statewide cost estimate was adopted, (2) test claims determined not to be mandates were considered complete at the time of determination, (3) and in a few instances, local entities withdrew their test claims from further consideration.

Figure 3
The Commission on State Mandates' Test Claim Backlog and Activity
July 2003 Through June 2009



Source: Reports by the Commission on State Mandates to the Legislature on approved or denied mandate claims.
 * Amounts for test claim backlogs represent those at the end of the period.

decisions in light of changes in law. Commission staff explained that because the Commission needed to complete these reconsiderations within statutory deadlines, the staff gave backlogged items lower priority than the reconsiderations. We discuss the Commission's staffing later in Chapter 1 and mandate reconsiderations in Chapter 3.

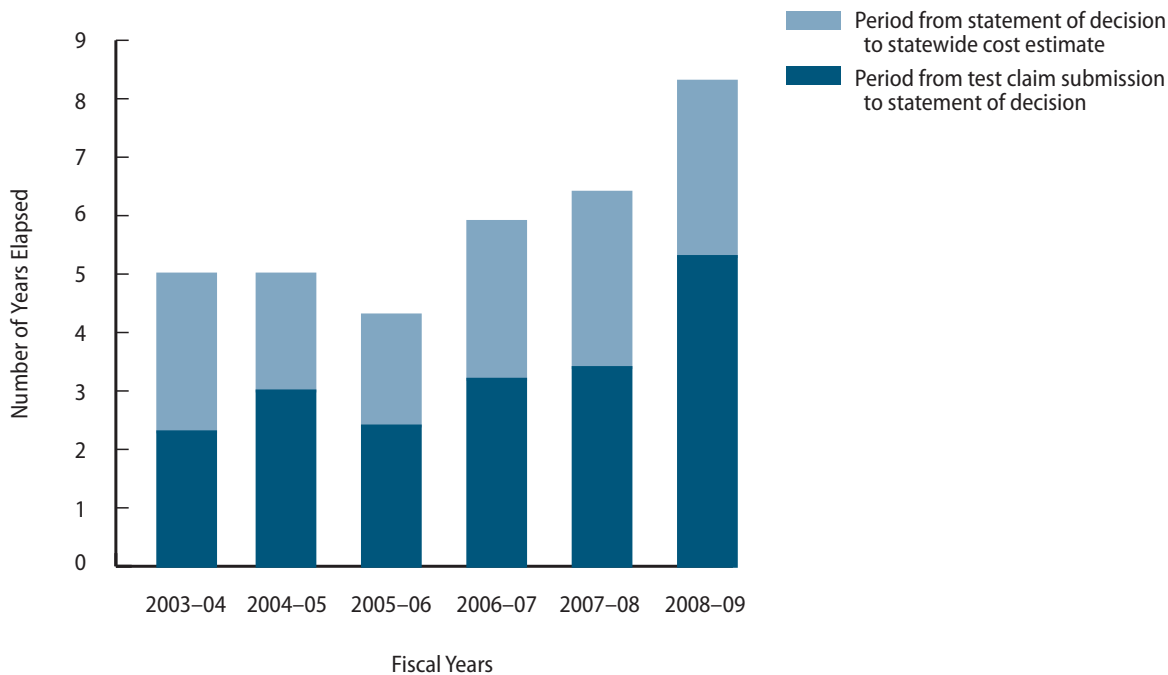
Commission Processing Times Extend Far Beyond the Time Frame Established in State Law

Between fiscal years 2003–04 and 2008–09, the Commission did not complete the entire process for any test claims within the time frame established in state law and regulations. Upon receipt of a test claim, the Commission has three distinct responsibilities: determining whether a mandate exists; issuing parameters and guidelines (guidelines) for an approved mandate; and adopting a mandate's statewide cost estimate. The Commission's legal staff perform the analysis that supports a mandate determination and adoption of the mandate's guidelines. Other staff assist with guideline analysis and prepare a mandate's statewide cost estimate.

When a mandate exists, state law requires the Commission to adopt a statewide cost estimate within 12 months after receipt of the test claim. This deadline can be extended for up to six months and may also be lengthened for postponement of Commission hearings.

In accordance with state law, the Commission's regulations establish a timeline of 365 days from the filing of a test claim to the adoption of a statewide cost estimate and also allow for interested parties to request extensions. Figure 4 shows the Commission's average length of time to process test claims for those approved as mandates that completed the entire process from fiscal years 2003–04 through 2008–09. During this period, the Commission's average elapsed time for completing the process was more than six years.³ During fiscal years 2003–04 through 2005–06, the average elapsed time for the process remained relatively steady at around five years. Yet between fiscal years 2006–07 through 2008–09, the average time increased to more than eight years.

Figure 4
Average Time Elapsed From Test Claim Submission to Statement of Decision and Statewide Cost Estimate
Fiscal Years 2003–04 Through 2008–09



Sources: Reports by the Commission on State Mandates (Commission) to the Legislature on approved mandate claims as well as Commission staff.

Note: This figure shows average processing times for test claims that were approved as mandates and that finished the entire process through the adoption of statewide cost estimates. Each fiscal year's average reflects the entire processing time for mandates completed during that fiscal year.

³ Commission staff indicate that they generally address test claims on a first-in, first-out basis and that a considerable amount of time may pass between the submission of a test claim and the point when they begin to work on it actively.

Commission staff indicate several causes for the lengthy processing times, including the complex legal analysis required to support test claim decisions, insufficient Commission staffing and budgetary resources, and delays due to interested parties' requests for extensions and postponements. We recognize that delays caused by extensions requested by interested parties have an effect on the timeliness of mandate decisions. For example, the process from test claim receipt through statewide cost estimate for the Stull Act⁴ mandate lasted nearly eight years, and four extensions delayed the adoption of the statewide cost estimate by a combined total of 15 months. These delays are similar to those of other recent mandates we examined. We reviewed the process for three other programs and determined that extensions and postponements varied between one and six months, while the process for each took around five years or more. Thus, for the mandates we examined, the impact of the extensions granted appears to be relatively small compared to the average length of time it has taken to complete the mandate process.

Commission staff describe the analysis involved with test claim decisions as complex. For example, they stated that there were 51 test claims filed in fiscal year 2002–03 and that these claims alleged that nearly 500 statutes and 400 regulatory sections and executive orders created additional mandates. Commission staff say that in order to meet statutory requirements, each statute, regulation, and executive order requires a finding by the Commission. The continuing backlog and the long periods that elapse before the Commission adopts statewide cost estimates, however, indicate that Commission staffing has not been sufficient to meet the demands involved with test claim analyses in a timely manner. We discuss the Commission's staffing in the next section.

Both the test claim backlog and the delays in processing create significant burdens on the State and on local entities. At the state level, these conditions keep the Legislature from knowing the true costs of mandates for years; as a result, the Legislature does not have the information it needs to take any necessary action. Often many years have passed between enactment of the law that created a mandate and the Commission's related statewide cost estimate. As a result, legislators who approved the law have likely left, and consequently so has their opportunity to examine the mandate's cost ramifications. Additionally, as the years pass, claims build, adding to the State's growing liability. Further, the slow process delays payments to local entities for many years. Therefore, local entities are required to perform mandated activities while funding

The slow test claim process contributes to the State's growing liability and delays payments to local entities for many years.

⁴ The Stull Act imposes requirements on schools districts to perform increased evaluations of their staff.

for the activities has stalled within the mandate process. In addition, delays in the test claim process create difficulty for both the State Controller's Office (Controller) and local entities when the Controller conducts audits. Local entities are uncertain about allowed activities and documentation requirements for many years after the enactment of the mandated activities. Therefore, conflicts arise when the Controller attempts to obtain documentation that supports actual claimed costs. We discuss the Controller's audits and these challenges further in Chapter 2.

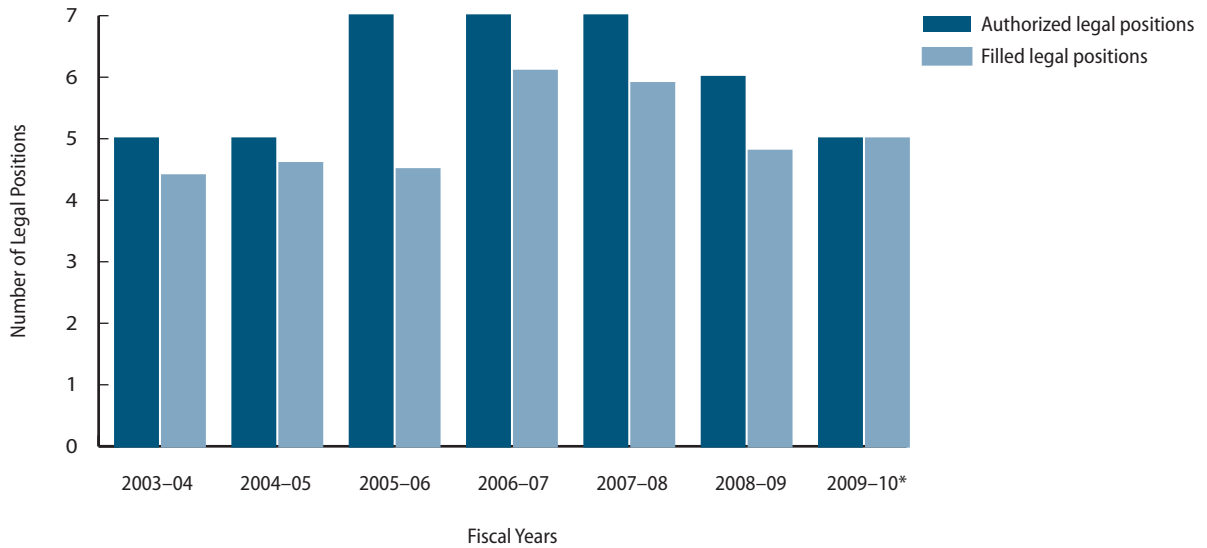
The Commission Did Not Fill All of Its Authorized Positions, and Some Positions Were Eliminated

Not only did the Commission not always fill its authorized staff positions during the period we reviewed, but it also experienced cuts in its authorized staff positions. As mentioned previously, the Commission's legal staff perform the test claim analysis that supports its mandate determinations. Figure 4, presented previously, shows that for test claims culminating in the adoption of a statewide cost estimate during fiscal year 2008–09, it took, on average, five years of the more than eight-year process to determine that a mandate exists. According to information encompassing the years since fiscal year 2003–04, the Commission's authorized positions reached their highest levels in fiscal years 2005–06 and 2006–07 at 14 overall positions; seven of these were legal positions that could work on test claim analysis.⁵

The Commission had problems filling all its authorized positions, including legal positions, and subsequently experienced staffing reductions. It had seven authorized legal positions in fiscal year 2005–06 but was only able to fill, on average, 4.5 of those positions. In subsequent years, the Commission experienced additional cuts, and it was still unable to keep all the attorney positions filled. From fiscal year 2006–07 through 2008–09, one attorney position, on average, remained vacant each year, and authorized positions fell by one. An additional attorney position was cut for fiscal year 2009–10. As of July 2009, the number of authorized positions had decreased to 10.5 overall, five of which were legal positions. Figure 5 details the authorized and filled legal staff positions that perform test claim analysis. According to Commission staff, positions were eliminated to meet targeted budget reductions imposed by the Department of Finance (Finance) and the Office of the Governor. In addition, one of the Commission's attorneys retired, and the Commission continues to have trouble recruiting qualified candidates for its legal positions.

⁵ Legal positions include the Commission's executive director.

Figure 5
The Commission on State Mandates' Authorized and Filled Legal Positions
Fiscal Years 2003–04 Through 2008–09



Sources: The Department of Finance's *Salaries and Wages* supplements and Commission on State Mandates (Commission) staff.

Notes: The figure includes two temporary positions that were authorized starting in fiscal year 2005–06. These positions were made permanent in fiscal year 2006–07.

Legal positions include the Commission's executive director.

* Fiscal year 2009–10 amounts are as of July 2009. Amounts for other periods cover the entire fiscal year indicated.

Commission staff describe the legal staff's work as complex, difficult, and intellectually challenging. They indicate that the Commission uses state-approved methods to obtain attorneys but have experienced some recruitment problems. They state the Commission has used various methods, such as the State Personnel Board's vacancy search system and the deputy attorney general lists. In addition, the Commission recruits from other state agencies and the private sector. Commission staff point out that most state agencies are required to contract with the Office of the Attorney General (Attorney General) to represent them. However, since the Attorney General represents the Controller and Finance, it cannot represent the Commission. According to staff, Commission attorneys appear in court on its behalf, and it has difficulty finding state attorneys with litigation and court experience. Staff told us that in fiscal year 2005–06, when the Commission was granted two new attorney positions, it had trouble filling one of the positions. Both positions were eventually filled. Nevertheless, the

Despite the State's budget issues, cutting staff who determine state mandates over the last few years has been shortsighted.

setbacks in filling and maintaining legal positions resulted in a net effect of one legal position remaining unfilled from fiscal years 2006–07 through 2008–09.

According to Commission staff, they continually evaluate the need for additional resources and discuss their needs with Commission members, Finance staff, and legislative staff. They point out that in recent years, increases in budgets have not been authorized due to the severe budget crisis faced by the State. Commission staff assert that because of the State's budget crisis, Finance has indicated that no resources can be added for fiscal year 2010–11. Nevertheless, Commission staff say they will continue to work with Finance to assess resource needs and to seek additional resources for completing their workload.

We believe that it would be wise for the Commission to pursue additional staff to reduce its backlog and delays. Despite the State's budget issues, cutting staff who determine state mandates has been shortsighted. Specifically, such actions over the last few years have contributed to delays related to stalled test claims that allow the buildup of millions of dollars of potential claims that the State is constitutionally required to reimburse. Because the backlog is significant and processing times are long, the Commission needs to request assistance to help reduce its workload after prioritizing and seeking efficiencies to the greatest extent possible.

Cost Estimates After Mandate Determinations Are Much More Accurate Than Initial Estimates

The Commission's statewide cost estimates of mandates are largely based on the actual claims local entities submit and are the first truly informed look at the cost of a mandate. The Commission is doing a good job of disclosing the basis of and limitations related to the underlying data. However, initial estimates by Finance when legislation is being proposed are inherently difficult to develop.

Commission Estimates Are Based on Actual Data, Allowing for More Accuracy

The Commission adopts statewide cost estimates and publishes them with relevant disclosures in periodic reports on new mandates to the Legislature. The estimates, which generally represent costs for past fiscal years, are used as a basis to appropriate funds to the Controller for the reimbursement of claims. State law requires the Commission to report to the Legislature at least

twice each year on the number of mandates it has found, the statewide cost estimates of those mandates, and the reasons for recommending reimbursement.

The Commission reports statewide cost estimates after it has adopted guidelines in which it determines the period for which local entities will receive reimbursement. This period is used in considering the amount of the initial appropriation for the mandate. The period can start years before the Commission adopts the mandate, and it varies from mandate to mandate. For example, the initial estimate for the Stull Act covered 11 years. The test claim for the Stull Act was filed in July 1999, but nearly five years elapsed before the Commission determined that this program was, in fact, a mandate. Another three years passed before the Commission adopted a statewide cost estimate in May 2007. In this instance the Commission's statewide cost estimate also included costs for the two fiscal years before the test claim was submitted and the fiscal year following the adoption.

Consistent with state regulations, the Commission typically bases its statewide cost estimates on actual claims submitted to date for the reimbursement period. The Commission can also include estimated costs for the last few years using other information, such as an inflation index. The Commission is required to hold at least one hearing on the estimates. When it adopts statewide cost estimates, the Commission lists the period of reimbursement covered and includes a breakdown of costs and an average annual cost. It publishes the cost estimates in periodic reports to the Legislature. Included in the reports are the methodology, assumptions, sources, and limitations of the data it used to create the cost estimates.

An audit we performed in 2003 found the statewide cost estimates for certain state mandates to be underestimated based on inherent limitations in the process the Commission used at the time. However, our current review of five large mandates⁶ reported to the Legislature since January 2004 shows that such cost estimates have become relatively accurate. As Table 2 on the following page shows, two of the five statewide estimates were within 5 percent of actual costs, with the remaining three estimates within 15 percent. Because some estimates overestimated and others underestimated actual costs, in aggregate the statewide cost estimate for these five mandates was within 1 percent of actual costs.

The Commission typically bases its statewide cost estimates on actual claims submitted for the reimbursement period.

⁶ We selected the two largest local agency mandates, the two largest school district mandates, and the largest community college mandate.

Table 2
Percentage Differences Between Selected Commission on State Mandates' Statewide Cost Estimates and Actual Approved Claims

MANDATE NAME*	NUMBER OF YEARS COVERED BY ESTIMATE	COMMISSION ON STATE MANDATES' STATEWIDE COST ESTIMATE	APPROVED ACTUAL CLAIMS	PERCENTAGE DIFFERENCE OVER/(UNDER) ACTUAL
Administrative License Suspension	8	\$9,975,928	\$10,876,435	(8.3%)
Handicapped and Disabled Students II [†]	5	15,159,333	13,533,118	12.0
Enrollment Fee Collection and Waivers	10	162,128,285	169,408,915	(4.3)
The Stull Act	11	182,828,898	177,103,203	3.2
High School Exit Examination	8	37,363,071	33,056,431	13.0
All Five Mandates		\$407,455,515	\$403,978,102	0.9%

Sources: Reports by the Commission on State Mandates (Commission) to the Legislature on approved mandate claims and by the State Controller's Office to the Legislature on program costs and payments.

* From mandates reported to the Legislature since January 2004, we selected the two largest state mandates for local agencies, the two largest for school districts, and the largest community college mandate. These five mandates accounted for 79 percent of the total value of statewide cost estimates reported by the Commission since that date.

[†] In May 2005 the Commission determined that Handicapped and Disabled Students II was a mandate. In 2006 this mandate was consolidated with the first Handicapped and Disabled Students mandate and with the Seriously Emotionally Disturbed Pupils mandate.

Realistic Early Cost Estimates Are Difficult to Develop

Providing meaningful cost estimates at the time the Legislature is considering legislation has proven to be more difficult. Since 1985 state law has required the Legislative Counsel to review each bill introduced to the Legislature and to determine if the bill mandates a new program or a higher level of service.⁷ If the Legislative Counsel determines that the bill creates a mandate, state law then requires Finance to provide a cost estimate for the bill. Finance generally generates cost estimates for the first three fiscal years of the bill and attempts to determine an annual cost for the program or higher level of service.

State law requires Finance to estimate the level of reimbursement that the mandate will require for the first fiscal year of operation in its cost estimate. Finance creates cost estimates by reviewing similar mandates and adjusting them for factors such as differences in the size of the population. Finance may use local estimates, if available, when no other information exists and attempts to foresee any indirect costs that could increase claims. However, according to Finance staff, difficulties in estimating costs related to seemingly

⁷ The authority for determining whether a law imposes a mandate rests with the Commission; the Legislative Counsel's determination is not binding on the Commission.

insignificant activities and indirect costs and in anticipating additional costs resulting from guidelines may create inaccurate cost estimates. To create better estimates, Finance has reviewed the guidelines adopted since 2006 for local entities in an attempt to discern the kinds of activities that result in additional costs.

Although our testing of the five large mandates covered mandates reported since January 2004, the mandates were based on a myriad of laws, the earliest of which date back to 1983. The most recent law used by the Commission in determining a tested mandate within the five we reviewed dates to 2000. As a result, we did not review any estimates Finance created within the last nine years.

Problems with the accuracy of initial estimates are illustrated by three of the five large mandates we tested, which are the three for which initial estimates were available. All five mandates we tested were based on multiple legislative bills, many of which indicated no reimbursable mandate costs. We focused on the remaining bills that had cost estimates. In each of the three where initial estimates were available, Finance did not quantify any major costs. In the first example, the Stull Act, Finance estimated that future costs would be major but did not quantify them, stating the costs were unknown. In the second and third examples, the bills for the Enrollment Fee Collection and Waivers mandate and the Administrative License Suspension mandate, Finance did not estimate any annual costs greater than \$2 million. The combined average annual approved claims for those three mandates from fiscal years 2003–04 through 2007–08 were \$41.9 million. For the final two large mandates, representatives from Finance and the State Archives told us there were no cost estimates on file related to the bills on which the mandates were based. For two of the bills we would expect Finance estimates as the bills indicate the Legislative Counsel had determined a mandate might be created. Because of the lack of data, we could not determine whether Finance produced cost estimates for those two mandates and, if so, how large they were. The fact that early estimates are inherently difficult to develop and that mandates are often based on legislation passed years or decades previously underscores the need to address the Commission's test claim backlog so the Legislature can act more quickly if the mandates generate significant costs that warrant attention.

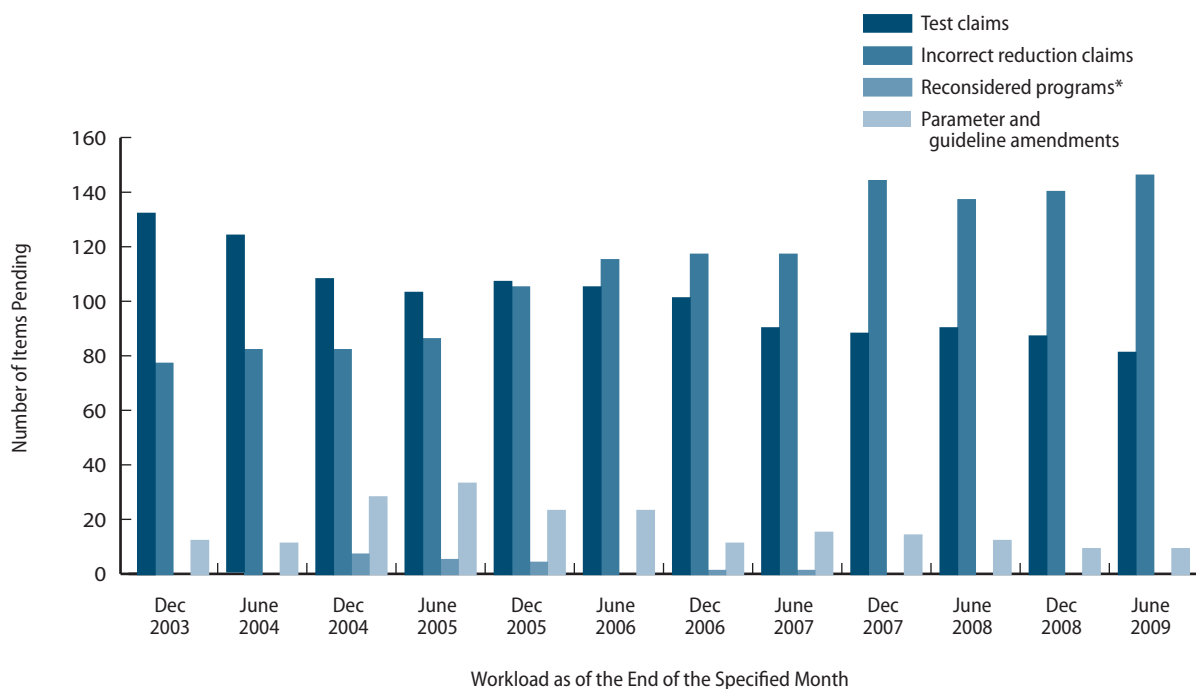
For each of the three mandates we tested where initial estimates were available, Finance did not quantify major costs.

The Commission's Backlog of Incorrect Reduction Claims Continues to Grow

The Commission has not addressed many local entities' incorrect reduction claims, allowing its backlog of these items to grow substantially. A local entity may file an incorrect reduction claim if

it believes the Controller has improperly reduced its claim through a desk review or field audit. The Commission serves, in effect, as the appeal authority that hears local entities' incorrect reduction claims and decides if the Controller's adjustments were appropriate. Commission staff indicate that attorneys and other staff review these items. However, the Commission has only completed a limited number of these claims, and consequently its backlog grew from 77 in December 2003 to 146 in June 2009. Figure 6 depicts the growing backlog of incorrect reduction claims in comparison to the Commission's other work items, including test claims.

Figure 6
The Commission on State Mandates' Outstanding Workload
December 2003 Through June 2009



Sources: Reports by the Commission on State Mandates (Commission) to the Legislature on approved and denied mandate claims as well as other Commission information.

Note: Test claims, incorrect reduction claims, reconsidered programs, and parameter and guideline amendments require differing levels of Commission resources. This figure presents the number of pending items, not the level of resources required to complete them.

* Reconsidered programs relate to situations where the Legislature asked the Commission to reconsider its past state mandate decisions. The Commission reconsidered 13 programs between December 2003 and December 2007. Due to a court ruling in 2009, the Legislature can no longer ask the Commission to reconsider its decisions.

During these five and one-half years, the Commission completed determinations on only seven incorrect reduction claims. These determinations implemented the decisions of two superior court cases related to the Graduation Requirements mandate. As of June 2009, \$57 million in contested claims remain outstanding; one incorrect reduction claim remains from September 2000, while the majority were filed in 2002. Many of the outstanding items are related to the same mandate program. The Investment Reports mandate accounts for 72 of the incorrect reduction claims pending and makes up nearly \$3 million of the total amount contested.⁸

*As of June 2009, \$57 million
in contested claims
remain outstanding.*

According to Commission staff, reductions to the Commission's authorized positions and budget have made it difficult to complete these items. As of August 2009 Commission staff had developed a plan to address the backlog. The plan depends on whether the Commission receives additional staff. If it does, the plan calls for hearings on the incorrect reduction claims to begin in July 2010. If additional staff are not provided, the plan proposes to complete the workload as time and resources permit. As discussed previously, it is the Commission's understanding that no additional resources will be provided to it for fiscal year 2010–11. Thus, it expects to complete the workload as time and resources permit.

The Commission has processed most requests for amendments to mandate guidelines. The Commission completed 61 of 70 requested guideline amendments between January 2004 and June 2009. These amendment completions addressed an influx of requests in fiscal years 2004–05 and 2005–06, including requests related to two programs we reviewed in our state mandate audit issued in 2003 on the Animal Adoption and Peace Officers Procedural Bill of Rights mandates.

Conversely, Commission staff postponed addressing a major amendment submitted by the Controller in April 2006 (boilerplate amendment), awaiting the outcome of litigation. The boilerplate amendment requests the incorporation of standardized language into the guidelines for 49 mandates determined before 2003. Specifically, it proposes standard rules for record retention and documentation requirements as well as the elimination of references to outdated Controller claiming instructions. This amendment addressed a recommendation from our 2002 state mandates audit. Staff state that the Commission has incorporated such language into all guidelines developed

⁸ The Investment Reports mandate requires local agencies to submit to their legislative bodies and others a statement of investment policy annually and investment reports quarterly.

after January 2003. Further, the Commission subsequently updated the boilerplate language in 2005 in response to a recommendation from our 2003 state mandate audit.

However, Commission staff said that pending litigation⁹ addressing documentation requirements for several mandates that originated before 2003 caused staff to suspend work on the boilerplate request. Although the Commission was not a party to this litigation, the case challenged the standards and rules, including those similar to Commission guidelines adopted after January 2003, applied in the Controller's auditing of mandate claims. Consequently, Commission staff believed it was not prudent to work on the Controller's boilerplate request, which includes amendments to the guidelines for those mandates. In its February 2009 decision, the court indicated that mandate guidelines can be used as valid rules for auditing mandate claims. Although this decision is on appeal, Commission staff developed a plan to work on the amendment request after we asked about the status of it in June 2009. Commission staff state they have scheduled 24 mandates for review in 2009 and 25 for review in early 2010. Completing its work on the boilerplate amendment could help to resolve issues of contention between local entities and the Controller. We discuss this matter further in Chapter 2.

Recommendations

To ensure that it resolves sufficiently its backlog of test claims, incorrect reduction claims, and the boilerplate amendment request, the Commission should do the following:

- Work with Finance to seek additional resources to reduce its backlog, including test claims and incorrect reduction claims. In doing so, Commission staff should prioritize its workload and seek efficiencies to the extent possible.
- Implement its work plan to address the Controller's boilerplate amendment.

⁹ *Clovis Unified School District v. State Controller.*

Chapter 2

THE STATE CONTROLLER'S OFFICE APPROPRIATELY OVERSEES MANDATE CLAIMS, BUT THE STATE DOES NOT MAKE TIMELY PAYMENTS

Chapter Summary

The State Controller's Office (Controller) uses a risk-based system for selecting the state mandate claims for reimbursement that it will audit, has improved its process by auditing claims earlier than in the past, has sought parameter and guideline amendments to resolve identified claims issues, and has undertaken outreach activities to inform local entities about audit issues. Nevertheless, continuing high reduction rates, reflecting large audit adjustments for some mandates, indicate that filling vacant audit positions and giving a high priority to mandate audits could save money for the State. In addition, lack of action on incorrect reduction claims by the Commission on State Mandates (Commission) has undermined the Controller's efforts to implement clear and consistent policies related to cost reimbursement. This has created uncertainty about what constitutes a proper claim. Finally, largely because of insufficient funding, the State's liability related to state mandates has grown despite state law intended to ensure more timely payments to local governments. Consequently, the ongoing need to pay for past mandate activities continues to affect adversely the State's ability to pay for current operations and to make future investments.

The Controller Appropriately Uses Desk Reviews and Field Audits to Process and Verify Mandate Reimbursement Claims

To ensure that local entities submit accurate claims, the Controller uses a strategy that combines desk reviews with field audits. Desk reviews are high-level reviews performed on all claims, and field audits, which are performed for selected claims, are detailed reviews examining source documentation. Reduction rates, stemming from field-audit adjustments, vary among mandate programs but have averaged 47 percent for audits begun since fiscal year 2003–04. In other words, the Controller has denied on average 47 percent of the claimed costs it has audited over this period. The Controller uses its audit results and other factors to identify high-risk programs for future field audits.

Desk Reviews Provide High-Level Screening of Mandate Claims

In recent years claim reductions at the desk-review level have constituted a relatively small portion of the overall claim reductions made by the Controller. However, large claim reductions can result when a mandate program is suspended or set aside and some local entities continue to file claims for the program. Suspended or set-aside mandate programs are not reimbursable to local entities as state mandates for a given fiscal year. During the period when a mandate is suspended or set aside, local entities are not required to undertake activities stipulated for the mandate and are not eligible for reimbursements if they do. In such cases, the Controller can make legitimate reductions to the corresponding mandate claims.

Desk reviews performed by the Controller check claims for basic requirements. When local entities submit mandate claims to the Controller for reimbursement, staff review them to ensure that they are filed for the correct program and fiscal year, and are properly certified. Staff also perform a sample review of claims to ensure they are mathematically correct, and include required documentation, if necessary. The Controller's practice is to desk-review every mandate claim submitted for state reimbursement, which includes, on average, about 15,000 annual claims for various mandate programs. In cases where a claiming error is identified at this level, the Controller has the authority to reduce or reject it and the responsibility to inform the local entity of the error. After making necessary corrections, the local entity can resubmit the claim to the Controller for state reimbursement.

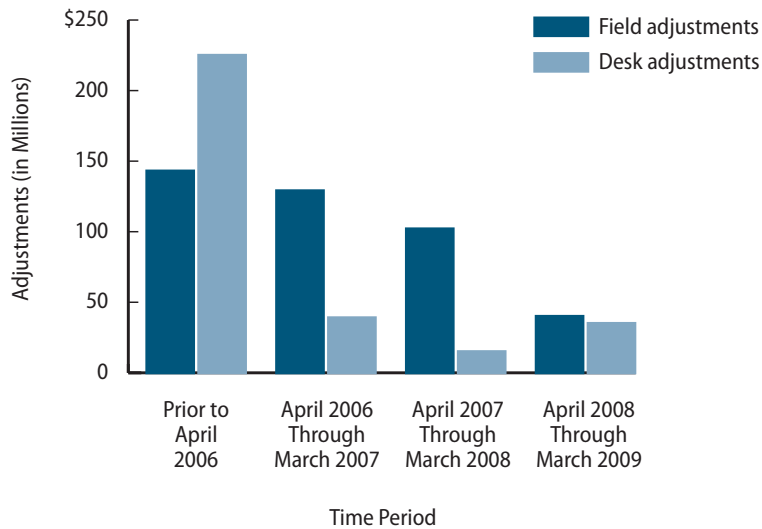
Desk review adjustments have accounted for only 25 percent of all claim reductions since April 2006.

In the period before April 2006, desk adjustments made up 61 percent of the total accumulated desk-review and field-audit claim reductions. However, as Figure 7 shows, desk-review adjustments constitute a much smaller portion of the claim reductions recorded by the Controller in the last few years, accounting for only 25 percent of all claim reductions determined by the Controller since April 2006. The primary reason for the drop in the percentage is the high level of desk adjustments the Controller made to claims under the School Bus Safety II mandate before April 2006. The adjustments, which were made because the mandate was set aside, totaled more than \$148 million or 66 percent of the desk adjustments before April 2006.

The manager of the Local Reimbursement Section mentioned another factor that contributed to the decrease in annual adjustments made through desk reviews. She said that over the last three years, her staff have focused on developing an electronic system for filing reimbursement claims. As of August 2009 she said the system was available, but it did not yet cover all mandates.

She anticipated that the system would be fully operational in 18 months, leaving staff with more time to analyze claims and identify potential claim adjustments.

Figure 7
Field Audit and Desk Review Adjustments
Through March 2009



Source: State Controller's Office reports of audit findings for state mandates.
 Note: Reports do not provide adjustment data by year before April 2006.

Field Audits Are Detailed Reviews That Can Yield Significant Reductions in Claim Amounts

Field audits can lead to large dollar cuts in mandate claims for state reimbursement. The Controller disallows portions of mandate claims when it finds they include activities that are not reimbursable according to the parameters and guidelines (guidelines) established by the Commission or are not supported by source documentation. The Controller has the authority to audit mandate claims to identify claiming errors and needed revisions to the guidelines. Although all mandate claims are reviewed at the desk level, the Controller only conducts field audits on select mandate claims. The Controller performs an annual risk-based analysis to identify potentially costly errors in an effort to use its field-audit resources as efficiently as possible. The result is a list of potential candidates for future audits (audits listing).

In its review the Controller considers mandates with high-dollar claims, high claims in relation to population or enrollment, systematic claiming issues per past audits, new mandate programs,

and other factors to identify the mandate-entity combinations most likely to include errors. For example, the Stull Act mandate imposes requirements on school districts to perform increased evaluations of their staff. We noted two school districts, each with an enrollment between 8,500 and 8,700. One school district's Stull Act mandate claim for fiscal year 2006–07 reflected a high dollar amount—\$34 per student—in relation to its enrollment; the other school district's claim was only 17 cents per student and would be considered less likely to include overstated costs.

Most of the time, the Controller selects claims to audit from its audits listing. However, audits are sometimes started for mandates and entities that were not initially identified as being high risk. For the last four fiscal years, the Controller began an average of eight audits, out of a total average of 58 audits it started each year, on entities that it had not previously identified as high risk. According to the chief of the Controller's Mandated Cost Audits Bureau (audits chief), such audits are performed in response to new information that suggests a high-risk claim and to facilitate the training of new audit staff.

Claims filed for reimbursement are subject to the initiation of an audit by the Controller no later than three years after the date the actual claim is filed or last amended, whichever is later, unless no funds are appropriated or no payment is made to a local entity. In the latter situation, the three-year period begins on the day the initial payment is made. Further, any audit started by the Controller must be completed within two years of the date started. As of May 2009 the Controller had audited 36 percent of the total \$466 million in claimed dollars for mandate costs incurred during fiscal year 2003–04, 29 percent of claimed costs for fiscal year 2004–05, and 22 percent of claimed costs for fiscal year 2005–06.

Because the State has failed to pay many claims, as discussed later in this chapter, the Controller's window for initiating field audits is still open for certain mandate programs and claims. According to the audits chief, the statute of limitations for costs incurred for fiscal year 2003–04 is still open for many claims either because they are initial filings for new mandates or because the State has delayed their payment. Therefore, significant claims may still be audited for fiscal year 2003–04. Nevertheless, he indicated that further audit efforts may not significantly increase the audit coverage rate for fiscal year 2003–04 claims. The coverage percentages for later years should increase as the Controller continues to perform audits of claims prior to the expiration of the statute of limitations for them.

Nothing precludes the Controller from initiating audits once the Commission has adopted guidelines and local entities have submitted claims. In fact, it is advantageous for the Controller

The Controller has audited 36 percent of the claimed dollars for mandate costs incurred during fiscal year 2003–04.

to audit claims as soon as possible in order to identify promptly possible misunderstandings among local entities about reimbursable activities and acceptable forms of supporting documentation. The sooner the Controller can identify problem areas, the sooner it can propose changes to guidelines that can help local entities submit more accurate claims and avoid future audit adjustments. Earlier auditing can also help the State avoid the situation in which it must go through the process of recovering funds it has already paid. In our 2003 audit of state mandates, we found that the Controller had not performed audits of the two mandates on which our report focused; in both cases, the mandates had substantial claims. At that time, the Controller indicated that its focus was on auditing paid claims to ensure that any inappropriate claiming could be identified before the three-year statutory time limit for auditing those claims expired. We recommended in our 2003 audit that in the future it undertake audits sooner to get a jump on possible problems. During this audit, we found that the Controller had changed its process since our previous review to allow for earlier audit initiation and may start audits before making its first payments to local entities.

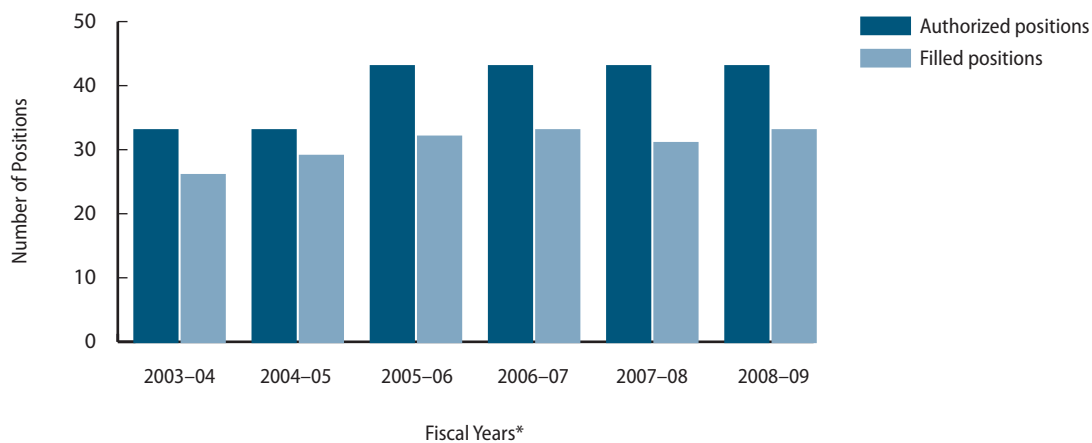
Audit efforts on state mandates, undertaken by the Mandated Cost Audits Bureau within the Controller's Audits Division, were greatly aided by a 175 percent increase in audit staff positions (from 12 to 33) in fiscal year 2003–04. However, the Controller was not able to take as much advantage of an additional increase of 10 staff positions two years later. Effective fiscal year 2003–04, the Controller successfully submitted a budget change proposal, increasing authorized field-audit positions from 12 to 33. Then in fiscal year 2005–06, the Legislature temporarily increased field-audit staff to 43. These positions became permanent with the approval of another budget change proposal, which became effective in fiscal year 2007–08.

Although the Controller's effort to increase authorized audit positions has been successful, it has not been able to keep all of its positions occupied. As displayed in Figure 8 on the following page, the Controller has had 10 or more authorized field-audit positions unfilled since fiscal year 2005–06. According to the audits chief, the Controller has been unable to fill the additional 10 staff positions because of the erosion of its budget over time when General Fund responsibilities have not been funded. In addition, he said that uncompetitive pay has led to its difficulties in hiring and retaining staff. Finally he noted that the Audits Division has continually had to assess its priorities and allocate resources to activities paid for by the General Fund, such as mandate audits, and those supported by other funds, such as bond-funded programs. Given the recent reduction in staffing in the Controller's budget and other budget pressures, the Controller sees no relief in being able

The Controller has changed its process to allow for earlier audit initiation and may start audits before making its first payments.

to fill vacant mandate auditor positions. In light of the substantial amounts involved, however, filling these positions to maximize the Controller's audits of mandate claims is important to better ensure that the State makes only appropriate reimbursements.

Figure 8
The State Controller's Office Authorized and Filled Field Audit Positions
Fiscal Years 2003–04 Through 2008–09



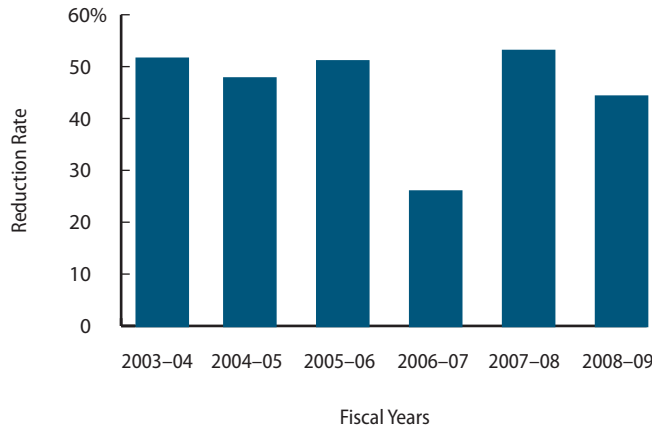
Sources: Chief of the Mandated Cost Audits Bureau of the State Controller's Office and relevant budget change proposals.

* Staffing positions are as of June of each fiscal year. The figure includes 10 temporary positions that were authorized beginning in fiscal year 2005–06. These positions became permanent in fiscal year 2007–08.

Reduction Rates Are High on Average, but They Vary Significantly Among Mandates

The Controller has reduced 47 percent of the cumulative dollars it has field-audited for all mandate audits initiated since fiscal year 2003–04, cutting about \$334 million in claims. As indicated in Figure 9, the reduction rate has usually hovered around 50 percent. However, the reduction rate for audits initiated in fiscal year 2006–07 is much lower at 26 percent. Data for that fiscal year showed that the Handicapped and Disabled Students I and II mandate accounted for 62 percent of the audited dollars but had a low reduction rate of only 5 percent. We discuss the Controller's reasons for its focus on this mandate as part of our discussion of Figure 10. Excluding the results of this mandate, the reduction rate was 59 percent for audits started in fiscal year 2006–07.

Figure 9
Reduction Rates for the State Controller’s Office Field Audits
According to Fiscal Years That Audits Began
Fiscal Year 2003–04 Through May 2009

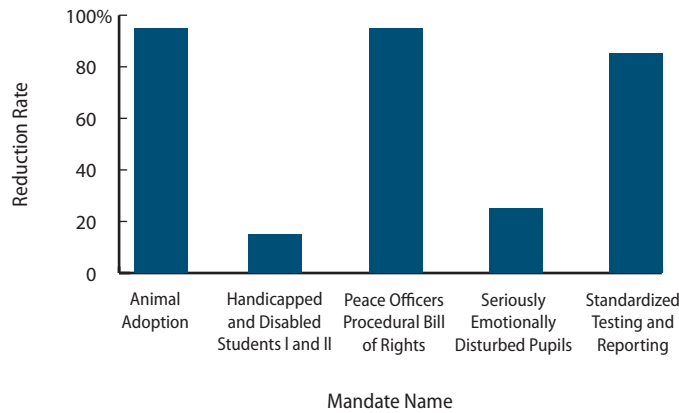


Source: The Bureau of State Audits’ analysis of audit result data obtained from the State Controller’s Office.

Note: Fiscal year 2008–09 information is as of May 2009.

The high overall reduction rate masks significant differences in the reduction rate among various mandate programs. For large mandates we highlighted for special attention, the average reduction rate for audits started after the beginning of fiscal year 2003–04 and completed by May 2009 ranged from 15 percent to 95 percent, as indicated in Figure 10 on the following page. The Controller reduced only 15 percent of the audited dollars for Handicapped and Disabled Students I and II mandate claims, but it reduced 95 percent of the audited dollars for two other mandates—the Animal Adoption mandate and the Peace Officers Procedural Bill of Rights (Peace Officer Rights) mandate. The Controller has field-audited, or as of May 2009 was in the process of auditing, 86 percent of the \$29 million in fiscal year 2003–04 Peace Officer Rights mandate claims. However, as of that date the Controller had audited, or was in the process of auditing, only 31 percent of Animal Adoption’s \$23 million in claims for fiscal year 2004–05, although the reduction rate is just as high.¹⁰

¹⁰ For the mandates we reviewed, we identified the amount of audit coverage for the earliest year of costs since July 2003 because that is when we would expect the highest audit coverage of claimed dollars. Fiscal year 2004–05 is the earliest year for Animal Adoption because the mandate was suspended, and thus not reimbursable, for fiscal year 2003–04.

Figure 10**Average Field Audit Reduction Rates for Highlighted Mandates
Fiscal Year 2003–04 Through May 2009**

Source: Bureau of State Audits' analysis of audit result data obtained from the State Controller's Office.

Notes: We selected specific mandates for highlighted review throughout our audit. However, as of May 2009, no audit reports had been published for the Stull Act or the Enrollment Fee Collection and Waivers mandates, and the Graduation Requirements mandate had no audits started since before July 2003. Thus, these three highlighted programs do not appear in this figure.

The Handicapped and Disabled Students I and II and the Seriously Emotionally Disturbed Pupils mandates were not combined at the time these audits were conducted.

The reduction rate for the Animal Adoption mandate is based on the one audit report published for this mandate through May 2009; however, it is in line with the very high error rates we found in our testing of this mandate in 2003. The Controller's audit report indicates that 49 percent of the reduction is attributable to unsupported salary and benefit costs. The audited city claimed salary and benefit costs based on year-end estimates, and the Controller has given the city an opportunity to perform a time study to be reviewed later. Since a high amount of the reduction is attributable to the year-end estimates, the reduction rate could be significantly reduced if the time study supports the claim. According to the audits chief in July 2009, the city recently indicated its completion of a time study. He said the Controller plans to review the study and revise the audit report as appropriate.

Also, the audits chief indicates that the Controller considers the statute of limitations in performing field audits and that additional Animal Adoption reports will be performed later on, increasing its audit coverage, because most Animal Adoption claims have not been paid. However, as we already noted in this chapter, auditing claims sooner rather than later avoids having to recapture amounts that have already been paid. In addition, had the Controller filled more of its vacant audit positions, it would have had more resources available to devote to mandates such as Animal Adoption.

The Standardized Testing and Reporting (Standardized Testing) mandate also has a high reduction rate. The rate is 85 percent; however, only 23 percent of the \$22 million in Standardized Testing claims submitted for fiscal year 2003–04 have been field-audited or are in the process of being field-audited. According to the audits chief, since the three-year statute of limitations to initiate field audits is still open for older Standardized Testing claims due to their not being paid, the Controller plans to audit additional older Standardized Testing claims in the future. The audits chief stated that the Controller has recently directed efforts to perform audits of mandates where claims have been paid or partially paid and the window of opportunity for audits is closing.

In contrast, the Handicapped and Disabled Students I and II mandate for the six-year period has a low reduction rate of 15 percent, yet the Controller has expended significant efforts in auditing these mandate claims. Detailed field audits of 93 percent of the \$65 million in fiscal year 2003–04 claims have been performed or are in process. According to the audits chief, a primary reason that field audits were performed to this extent was that the claimed costs for this mandate were significant. In fact, costs for this mandate were by far the largest in that fiscal year. He also said that around fiscal year 2002–03 the Department of Finance (Finance) was considering a proposal to change the first Handicapped and Disabled Students mandate to a block grant and asked the Controller to perform expanded audits of this program to gain audited cost data. Similarly, the Seriously Emotionally Disturbed Pupils mandate has a relatively low reduction rate of 25 percent, while its audit coverage for fiscal year 2003–04 is 96 percent of submitted claimed dollars for the program. However, the claimed dollars only totaled \$22 million for fiscal year 2003–04. The audits chief explained that a local entity's Seriously Emotionally Disturbed Pupils claims are often audited along with its Handicapped and Disabled Students I and II claims because the programs have interrelated costs.¹¹

Despite the fact that the Graduation Requirements mandate has been in existence since 1987, the Controller has not audited it recently. Graduation Requirements mandate claims had a reduction rate of 54 percent for field audits initiated in fiscal year 2002–03. Although the reduction rate was relatively high, the Controller has not audited any of the claimed dollars for costs incurred during fiscal years 2003–04 through 2008–09. This mandate has been the subject of litigation. In June 2009 the Controller issued new claiming instructions based on revised Commission guidelines.

¹¹ The Handicapped and Disabled Students I and II and Seriously Emotionally Disturbed Pupils mandates were consolidated into one mandate in 2006.

These instructions require all local entities to file prospectively using a reimbursement formula for teacher salary costs and grant all local entities the opportunity to refile claims retrospectively to fiscal year 1995–96.¹² In July 2009 the audits chief told us that the Controller planned to consider the Graduation Requirements claims for audit now that the litigation is resolved and the reimbursement methodology clarified.

Commission Backlogs Have Hindered the Controller’s Efforts to Fix Problems

To update local entities on the mandate process and prevent the claiming of nonreimbursable costs, the Controller has taken steps to inform local entities about state mandates through its Web site and outreach opportunities. In addition, the Controller has requested changes to mandate guidelines to clarify problems specific to particular mandates and to bring consistency to mandate requirements in general. Inaction by the Commission on incorrect reduction claims has partially thwarted these efforts by leaving disputes unresolved.

The Controller Uses Outreach to Discuss Claim Issues Directly With Local Entities

Outreach conducted by the Controller addresses mandate issues identified through field audits, such as the failure to adequately support employees’ time charges. The Controller communicates these issues through workshops, presentations, and meetings. Outreach events are usually held by other organizations, such as the California State Association of Counties or School Services of California, Inc., although the Controller sometimes coordinates and makes efforts to inform local entities of these activities. The Controller participated in 28 such events between January 2008 and July 2009. It uses another key method to communicate audit-related issues to local entities and the consultants who assist them with their claims. The Controller maintains a state mandate Web site with claim instructions, reports, time study guidelines, a Listserv, and a frequently-asked-questions document. The frequently-asked-questions document addresses general mandate issues—such as claim due dates and record retention requirements—and program-specific issues—such as the pitfalls of claiming costs for a particular mandate that are not reimbursable under its guidelines. In July 2009 the Controller revised its frequently-asked-questions document to specifically address local agencies in addition to educational agencies.

The Controller addresses mandate issues through workshops, presentations, and meetings.

¹² In Chapter 3, we discuss the use of reimbursement formulas.

To Resolve Identified Issues, the Controller Requests Amendments to Guidelines

The Controller sends amendment requests to the Commission to clarify the guidelines of certain mandates that the Controller and local entities interpret differently. The Controller frequently disagrees with local entities about documentation requirements for older mandates where the guidelines may be unclear. To clarify claiming issues or address changes in law, the Controller requests the Commission to amend the guidelines of certain mandates. Specifically, if the Controller finds that issues identified in audited claims are a result of a deficiency in the guidelines for the mandate, it sends a request to the Commission to amend the mandate's guidelines. For example, in response to a recommendation from our 2003 audit report on state mandates, the Controller proposed an amendment to the guidelines to reflect a revised formula for measuring the reimbursable portion of building or acquiring additional shelter space for the Animal Adoption mandate.

To address a recommendation from our 2002 state mandate audit report, it also worked with the Commission to develop boilerplate language to integrate into all guidelines adopted beginning in early 2003. In April 2006 the Controller requested that the Commission incorporate several portions of the boilerplate amendment into the guidelines for many older mandates. Existing mandates that had guidelines adopted before 2003 do not include the standard boilerplate wording. This request would primarily address issues related to what constitutes acceptable documentation. As discussed in Chapter 1, Commission staff decided to defer processing this request until the court reached a decision in *Clovis Unified School District v. State Controller*. The lower court reached a judgment on this case in February 2009, and although it has been appealed, Commission staff indicated to us in July 2009 that they had developed a plan to process this amendment request.

Pending Incorrect Reduction Claims Undermine the Controller's Audit Results

As of June 2009, \$57 million in incorrect reduction claims swelled the Commission's backlog. Local entities that disagree with cuts to their claims made by the Controller may file incorrect reduction claims with the Commission, which adjudicates the dispute. A significant number of outstanding incorrect reduction claims can cast a shadow over the Controller's efforts to ensure appropriate claiming by local entities.

The Controller worked with the Commission to develop boilerplate language to integrate into all guidelines adopted beginning in early 2003.

As mentioned in Chapter 1, the Commission has taken little action to resolve the complaints raised by local entities about reductions. Its inability to resolve these claims because of staffing limitations and other priorities leaves local entities uncertain about what qualifies as reimbursable costs. Further, until the incorrect reduction claims are resolved, the Controller may continue to make similar field-audit reductions that are reversed later by the Commission. Conversely, if the Commission ultimately finds the Controller's reductions to be correct, local entities will have continued to submit inappropriate claims until the time the Commission makes its decision. Either way, speedier resolution of outstanding incorrect reduction claims would allow the Controller to conduct audits with an awareness of the Commission's decisions and to incorporate those results into its audit findings and outreach efforts. The pending reduction claims also indicate a possible understatement of the State's mandate liability because of the fact that claim reductions may be reversed. This keeps the Legislature from being able to assess the true cost of mandates. Finally, when incorrect reduction claims are later upheld, local entities are deprived of the use of the money while the matter is being decided.

The Outstanding Mandate Liability Remains High and Is Likely to Continue Increasing

The outstanding liability for state mandates has grown to \$2.6 billion because of the steady amount of annual claims and erratic funding from the Legislature. The outstanding liability may continue to increase due to new mandate determinations and recent developments that could result in additional liabilities.

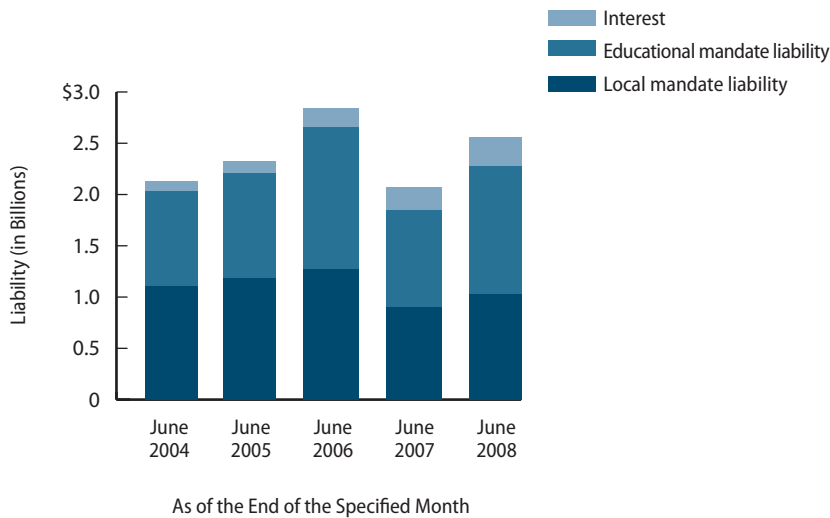
The total outstanding liability for state mandates is composed of local mandate liabilities, educational mandate liabilities, and interest owed on unpaid claims. Educational mandate liabilities have been the largest component for each fiscal year-end after June 2005. Before that, local mandate liabilities were the largest component at the end of both June 2004 and June 2005, but in subsequent fiscal years have dropped to the second-largest component. As Figure 11 shows, the total outstanding mandate liability rose from \$2.1 billion at June 2004 to a high of \$2.8 billion at the end of fiscal year 2005–06. It then dropped somewhat at June 2007, before rising to \$2.6 billion at June 2008.

A recent change in state law eliminated a requirement that local entities submit estimated claims to the Controller in February in anticipation of actual claims for that year. Instead, they now report only actual claims by February following the end of the previous fiscal year. Consequently, the Controller has not yet recorded any claims for fiscal year 2008–09 in its mandate

The outstanding mandate liability has grown to \$2.6 billion at June 2008.

reimbursement system. Nevertheless, local entities are still required to undertake mandated activities, and given the steadiness of reimbursement claims over the previous five years, it seems likely that additional claims related to fiscal year 2008–09 activities will amount to at least \$450 million. Because the State appropriated only \$27.9 million for state mandates in fiscal year 2008–09, the total outstanding liability at June 30, 2009, is likely to be around \$3 billion. In the past three years, the Controller has reported the mandate liability in March of the following fiscal year.

Figure 11
Outstanding State Mandate Liability
June 2004 Through June 2008



Source: Annual summary by the State Controller’s Office of the state mandate liability.

Moderate growth in annual claims, in part related to the reconsideration of certain mandates and to program suspensions, helped slow an increase in the mandate liability. Primarily in 2004 and 2005, the Legislature directed the Commission to reconsider its decision on a number of mandates based on new laws underlying the mandates. Subsequently, the Commission set aside the guidelines for these mandates, including Open Meetings/Brown Act Reform, School Accountability Report Cards, and Mandate Reimbursement Process. These three mandates accounted for about \$42 million a year in approved claims before the Commission set them aside, so the effect was substantial. State law says that if the Legislature specifies that it will not provide reimbursement for a mandate in a particular year, local entities need not carry out the mandated activities. This process is referred to as mandate suspension. If the Legislature deletes funding for the mandate

Erratic funding by the Legislature has contributed to the growth in the outstanding liability for state mandates.

but it does not specifically identify the mandate as suspended, state law says local entities may seek a court order declaring the mandate unenforceable. The State does not enforce suspended mandates during the suspension year, and local agencies cannot claim reimbursement for them. From June 2004 to June 2008, there were seven newly suspended programs, which together averaged \$13 million annually in the two years prior to their suspension.

Conversely, erratic funding by the Legislature has contributed to growth in the outstanding liability for state mandates. Between fiscal years 2004–05 and 2007–08, the annual level of funding for state mandates ranged between \$58.4 million and \$1.2 billion, and fiscal year 2006–07 was the only period when funding was greater than approved claims. In addition, the Legislature has extended repayment of local claims for years before fiscal year 2004–05. In 2004 the Legislature established a five-year plan for payment of this balance, but in 2005 it extended the plan by 10 years, until fiscal year 2020–21. In April 2009 the Controller reported that the outstanding balance to be paid on these old claims totaled \$931 million.

Recent developments could also significantly increase the mandate liability. First, in March 2009 a state court of appeal found that the Legislature did not have the authority to compel the Commission to reconsider its decisions and that certain mandates should therefore continue to be reimbursable.¹³ This ruling allows local entities to file claims under these mandates for the intervening fiscal years. As mentioned previously, before they were set aside, the annual claims for these mandates were substantial. We discuss this matter further in Chapter 3.

Second, for the Graduation Requirements mandate,¹⁴ the Legislative Analyst's Office (Legislative Analyst) in a February 2009 report noted that the resolution of litigation mentioned earlier in this chapter may result in significant additional costs to the State. The Legislative Analyst estimated that the outstanding liability for this mandate, reflecting costs as far back as fiscal year 1995–96, could total about \$2 billion and that annual ongoing mandate costs could amount to roughly \$200 million, resulting in part from the reimbursement formula adopted by the Commission.

Finally, in December 2008 the State and school districts reached a tentative settlement agreement related to the Behavioral Intervention Plans mandate contingent on certain conditions, such

¹³ *California School Boards Association v. State of California*.

¹⁴ The Graduation Requirements mandate requires all students to complete an additional high school science class.

as the Legislature appropriating necessary funding. This mandate relates to a requirement that school districts conduct one particular type of behavioral assessment followed by a particular type of behavioral interventional plan for any special education student exhibiting serious behavioral problems. The tentative settlement provided for a retroactive reimbursement to school districts of \$520 million, to be paid between fiscal years 2009–10 and 2016–17, and \$65 million in ongoing annual costs beginning in fiscal year 2009–10. However, the Legislature did not appropriate the necessary funding. Finance indicates a settlement could be considered next year.

Recommendations

To ensure that it can meet its responsibilities, including a heightened focus on audits of state mandates, the Controller should work with Finance to obtain sufficient resources. Additionally, the Controller should increase its efforts to fill vacant positions in its Mandated Cost Audits Bureau.

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Chapter 3

RECENT STRUCTURAL CHANGES HAVE NOT BEEN WIDELY EMBRACED, INDICATING THE NEED FOR EXAMINATION OF FURTHER REFORMS

Chapter Summary

Legislation affecting the structure of the state mandate system has yielded limited results. Additionally, a recent court decision has posed challenges for revising mandates. New processes intended to relieve the Commission on State Mandates (Commission) of some of its work have rarely been used. When used unsuccessfully, these processes can lengthen its time to process mandates. These options have, however, been available for less than two years, and the State has done little to promote them. In addition, a recent court case took away the Legislature's ability to direct the Commission to reconsider mandate decisions in light of law changes. Although this avenue was barred, it is important that the State have a process that allows the Commission to revisit mandate determinations when appropriate. The Department of Finance (Finance), the Legislative Analyst's Office (Legislative Analyst), and local entities have floated mandate reform ideas that address problems such as those related to initial cost estimates and delays in mandate funding. Although reform proposals may entail other considerations, they merit further study given the significance of the costs associated with state mandates.

New Mandate Processes Have Been Used Rarely and Appear to Have Limited Applicability

Effective January 2008 a new law established two alternative processes for determining reimbursable mandate costs and for developing estimates of the cost for mandates. These alternatives have limited applications and have not yet been implemented regularly. The legislatively determined mandate process (legislatively determined process) allows Finance and a local entity to develop a reimbursement methodology using a formula rather than basing it on detailed actual costs. The formula may contain a factor related to the mandate activity, such as units of input or output. Finance and the local entity then present the proposed formula and related cost estimate to the Legislature. By accepting them and enacting state law, the Legislature recognizes the existence and cost of the mandate, entirely eliminating the Commission's role in the process.

By relieving the Commission of some of its work, new processes could give Commission staff more time to address their work backlog.

Under the second new process, within 30 days of the Commission's statement of decision recognizing a new mandate, Finance and the local entity that submitted the test claim notify the Commission of their intent to pursue the jointly developed reasonable reimbursement methodology process (joint process). In this process, Finance and the local entity again join to create a formula for reimbursement. In their letter of intent to follow the joint process sent to the Commission, Finance and the local entity must include the date on which they will provide the Commission with an informational update regarding their progress in developing the formula.

Although under the joint process Commission participation is not eliminated, it greatly reduces the Commission's workload related to establishing a mandate's guidelines and adopting a statewide cost estimate. The Commission reviews the formula to ensure that it has been developed according to statutory requirements; it does not examine the formula's detailed methodology. By relieving the Commission of at least some of its work, these new processes have the potential to give Commission staff more time to address the work backlog we discuss in Chapter 1. These processes are also beneficial to local entities because methodologies that involve formulas typically have much simpler documentation requirements, and to the State Controller's Office (Controller) because simpler documentation usually takes less effort to audit and should result in fewer claim adjustments.

The legislatively determined process outlined in the new law had not yet generated a new mandate as of August 2009, and the joint process had only been implemented once. Because it has produced no mandates, the ultimate success of the legislatively determined approach is unknown. As of August 2009 Finance was negotiating formulas for two mandates under this process. The joint process, although implemented just once, has failed to yield significant results. The Firearm Hearings for Discharged Inpatients mandate, the sole mandate to successfully follow the joint process as of June 2009, appears to be a very small mandate in dollar terms. With a statewide cost estimate of almost \$155,000 spanning nine fiscal years, an average annual cost of about \$17,000, the difference in process is unlikely to have provided significant benefits to the Commission, the Controller, or local entities. Although the Commission had a backlog of 17 mandates awaiting the adoption of statewide cost estimates as of June 2009, only three were on the joint process track.

Additionally, the Commission can work with Finance, local entities, and others, including the Controller, to develop a reimbursement formula for a mandate (Commission process) instead of adopting guidelines for claiming actual costs in the traditional way.

The Commission has had the authority to adopt formulas for years. However between 2005 and 2008, the Commission had to assure that proposed reimbursement formulas considered the costs of 50 percent of all potential local entities that could submit a claim for that mandate. Commission staff say that this standard was difficult to meet and that they denied several proposed formulas that did not meet the 50 percent criterion. Effective 2008 the Legislature eased statutory requirements for adopting formulas. Under the amended statutes, proposed reimbursement formulas require the consideration of costs from a representative sample of eligible local entities. The Commission process does not reduce the Commission's participation in setting mandate guidelines as drastically as does the joint process; however, it does provide the joint process's benefits related to simpler documentation requirements and less complicated audits.

Since the elimination of the 50 percent criterion, the Commission process has been used twice as of August 2009: in the development of reimbursement formulas for the Peace Officers Procedural Bill of Rights (Peace Officer Rights) and the Graduation Requirements mandates. Since the optional Peace Officer Rights reimbursement formula became available to local entities beginning fiscal year 2006-07, annual approved mandate costs have decreased by about \$3.8 million. Information provided by the Controller indicated that, of all local entities submitting claims, 75 percent used the reimbursement formula to file their Peace Officer Rights claims for fiscal year 2007-08. The decreased costs and high use by local entities for this mandate indicate that the formula method offers the potential for savings in mandate costs for the State.

Alternative Mandate Processes Are Feasible Only in Certain Situations

The most significant reason that the legislatively determined, joint, and Commission processes have not been used more often is that they are only workable under certain circumstances and are thus not as broadly applicable as the Legislature may have expected. The legislatively determined process is a good alternative for determining a reimbursement formula when Finance and local entities agree that a mandate exists and that it includes specific mandated activities. The joint process is preferable when Finance and local entities dispute the existence or requirements of a mandate, a dispute that is resolved before the Commission, but are then willing to negotiate funding levels. The Commission process is preferable when Finance and local entities continue to dispute significant aspects of the mandate. With the Commission as part of the process, local entities may feel reassured that all the activities indicated as reimbursable in the statement of decision will be used to develop the formula, while Finance is assured that only the

Since the optional reimbursement formula became available beginning fiscal year 2006-07, annual approved costs for the Peace Officer Rights mandate have dropped about \$3.8 million.

activities identified as reimbursable are included. The Commission process can also be more flexible than the joint process. It allows for the use of optional reimbursement formulas or the use of formulas for some activities and actual cost reimbursement for others.

The manager of Finance's Mandates Unit, which focuses on mandates in areas other than education, said that Finance has not been more proactive in initiating use of alternative processes because it concluded that mandates determined by the Commission since 2006 were not promising candidates. Either local entities had a significant disparity in costs based on unaudited survey data or Finance believed disagreements would continue because the Commission had denied many portions of the test claim when determining whether a mandate existed. Similarly, the Program Budget Manager (program manager) of Finance's Education Systems Unit, which deals with educational mandates, said that in one case the unit approached local entities to develop a reimbursement formula as an alternative to using the litigation process as the means to determine reimbursement and because the mandate appeared to be a good candidate for a reimbursement formula. However, the program manager stated that after surveying costs and developing a reimbursement formula, the local entities withdrew from the process.

Issues related to cost data, differing cost structures, or complex program design can raise insurmountable problems for the alternative processes.

Issues related to cost data, differing cost structures, or complex program design can raise insurmountable problems for the alternative processes. For example, according to the manager of Finance's Mandates Unit, a few attempts at developing reimbursement formulas have collapsed because it was not possible to obtain the representative sample of eligible local entities needed for support. The program manager of the Education Systems Unit believes it is even more difficult to obtain the necessary support for educational entities. Differing views on the quality of cost data may also block agreement. For instance, a consultant we talked to believes that Finance prefers to rely on audited cost data. He viewed this as another hurdle to gathering cost information and reaching final agreement.

In addition, both Finance and local entities point out the difficulty of agreeing on reimbursement formulas in situations where large variations in size among entities result in fundamentally different cost structures. For example, a formula that adequately covers the costs of a large entity may not be sufficient for a smaller district that does not benefit from the same economies of scale. Finally, the program structure of educational mandates may cause problems. For instance, the program manager of the Education Systems Unit believes that educational mandates have not been good candidates for reimbursement formulas because they usually do not relate to clear inputs or outputs that could be associated with a standard

payment rate. Thus, the traditional mandate process discussed in the Introduction, which involves setting guidelines that define activities to be reimbursed based on actual costs, may be preferable when cost data are difficult to obtain or when unit costs vary significantly among entities.

The State Has Done Little to Publicize Alternative Processes

Another factor that may be contributing to the lack of success of the new processes is the State's limited efforts to communicate them to local entities. While the manager of the Mandates Unit indicates that its outreach has been limited, Finance's Education Systems Unit has not participated in any outreach. The manager of the Mandates Unit explained that its limited outreach is partly due to reduced travel budgets that have restricted outreach to Sacramento area workshops. According to its program manager, the Education Systems Unit is not involved in any outreach but thinks that the majority of potential educational entities are aware of the alternative processes. Although not required by law, such outreach is important to ensure that local entities are aware of the alternatives available to them.

Finance's low level of outreach may have been mitigated in part by the Controller's presentations throughout the State, which have discussed the legislatively determined and joint processes. However, as of July 2009 neither Finance nor the Commission had provided information on their Web sites publicizing the existence of the three alternative processes. In July 2009, after we suggested that the Controller include information about the joint and legislatively determined processes on its Web site, the Controller updated its frequently-asked-questions document to include a brief description of these processes. Internet sites offer a relatively inexpensive way to reach a large audience and are a communication method the public has come to expect the government to use.

Unsuccessful Negotiations Can Cause Significant Delays

Although alternative processes offer potential benefits, when they fail they can delay the traditional mandate determination process. For example, two attempts to develop reimbursement formulas, one under the joint process and one under the Commission process, were unsuccessful, prolonging the Commission's process for adopting guidelines and statewide cost estimates. When Finance and the local entity notify the Commission of their intent to undertake one of these alternative processes, the Commission puts its normal process for establishing guidelines and a statewide cost estimate on hold. In one case, the Commission's process was

When alternative processes are unsuccessful, they can substantially delay the completion of the mandate determination process.

Additional information on the status of alternative processes would help inform the Legislature about how widely the reforms are being used and about delays that may be holding up certain mandates.

delayed for one year while Finance and local entities attempted to negotiate a reimbursement formula for the Criminal Statistics Report mandate, an effort that ultimately failed because they could not agree on any reimbursement formulas the local entities proposed. Similarly, the Local Recreational Areas: Background Screenings mandate was delayed 2.5 years while Finance and local entities unsuccessfully attempted to negotiate a reimbursement formula. This attempt started before the Legislature amended the requirements for the Commission process; however, the original standard was apparently not the primary obstacle to success as the effort ended in June 2008 after requirements were eased.

Currently, the Commission is not required to report on items moving through the alternative processes although it does report to the Legislature when it approves a reimbursement formula for a mandate. Additional information on the status of these items would help inform the Legislature about how widely the reforms are being used and about delays that may be holding up certain mandates.

A Recent Court Case Overturned Revised Test Claim Decisions

The Legislature is no longer able to use its past approach to address concerns regarding the Commission's test claim decisions in response to changes in law. In *California School Boards Association v. State of California*, decided in March 2009, a state court of appeal held that the Legislature's direction to the Commission to reconsider cases that were already final violates the separation of powers doctrine. It indicated state law contemplates that the Commission is a quasi-judicial body with the sole and exclusive authority to adjudicate whether a state mandate exists and is limited only by judicial review. However, the court stated that it did not imply that there is no way to obtain reconsideration of a Commission decision when the law has changed, but that the process for declaring reconsideration of a decision was beyond the scope of its opinion.

In 2004 and 2005 the Legislature directed the Commission to reconsider or set aside its decisions on specific mandates to reflect changes in law or to better reflect legislative intent. For three mandates addressed in the court case, the Commission revised its original decision after reconsideration as directed by the Legislature, determining them nonreimbursable. Before the reconsiderations, the Open Meetings Act/Brown Act Reform, School Accountability Report Cards, and Mandate Reimbursement Process mandates had combined annual approved claims totaling about \$42 million. As a result of the court's ruling, the Commission's decisions were reversed and the right to reimbursement for these mandates remains uninterrupted for local entities.

In April 2009 an Assembly Budget Subcommittee recognized the importance of reforming the reconsideration process and, according to Commission staff, directed Finance, the Legislative Analyst, and Commission and legislative staff to form a working group to develop legislation to establish a mandate reconsideration process consistent with the court decision. In response, Commission staff prepared a working draft for discussion. This proposal would allow the Commission to amend a test claim decision upon a showing that there has been a subsequent change based upon new or different facts, circumstances, or mandate law that supported the original mandate decision. Commission staff said that, as of late August 2009, no follow-up hearings or meetings to discuss the proposal have been held. Until a new reconsideration process is established, mandate guidelines may not reflect statutory or other relevant changes. Thus, the State could pay for mandate activities that are no longer required.

Participants in the Mandate Process Have Proposed Reforms That Merit Consideration

The mandate process suffers from various problems that have motivated stakeholders to contemplate numerous reform proposals. As noted previously, some improvements have been made, but other suggestions for reform have not. Given the ongoing problems and significant costs noted in previous chapters, we believe the State could benefit from taking a second look at structural reforms proposed in recent years. In particular, for new mandates state law requires the Legislative Analyst to recommend whether the mandates should be repealed, funded, suspended, or modified. The Legislative Analyst, as appropriate, also reviews specific existing mandates as part of its broader mission to advise the Legislature on state expenditures. Its reports have typically highlighted problem areas and recommended solutions. Similarly, Finance has offered suggestions to the Legislature, and it participates in implemented reforms. In addition, the Commission contracted with the Center for Collaborative Policy (Center) at California State University, Sacramento, to evaluate mandate reform ideas. The Center's 2006 report contrasted ideas from state and local representatives involved in the mandate process. Key consultants, some of whom have represented local entity associations, also provided insights when we asked them for their perspectives on mandate reform.

The experience of other states also offers possibilities for managing state mandates differently. States that provided us information generally have processes for dealing with state mandates that are not comparable with that of California. Nonetheless, we have included a few promising ideas from them, along with those from California's key mandate players, in Table 3 on the following page.

Various entities, including the Legislative Analyst, Finance, and the Center for Collaborative Policy have put forward ideas for mandate reform.

This table summarizes potential reforms that could fundamentally change California's state mandate system. It excludes reforms that the State has recently adopted, such as the use of reimbursement formulas, those focused on individual mandates, or those aimed at fine-tuning existing processes.

Table 3
State Mandate Issues and Proposed Reforms

	ISSUE	PROPOSED REFORM	POTENTIAL CONSIDERATIONS
Pre-mandate processes	Costs are frequently underestimated when the Legislature initially creates a mandate; costs can exceed expectations.	Create a mandate cost review committee composed of state and local representatives to review bills while in the legislative process and provide information about what mandates would entail.	Legislative members could gain additional awareness about the cost of laws that impose a reimbursable mandate. Costs and issues related to legislation could be evaluated up front.
		Use pilot projects in selected local entities to test potential new mandates or changes to existing mandates before applying them statewide.	Pilot projects could help identify unworkable provisions and undesirable effects of new programs or procedures, and these projects could clarify fiscal impacts before full implementation.
	Delays in the test claim process and its eventual effect on mandate funding undermine protection of local entities and increase the State's mandate liability.	Impose a fiscal disincentive for delays in the test claim process, which are caused by the Commission on State Mandates (Commission) and other parties, beyond the statutory time frame. For example, interest could be charged on unpaid claims associated with late mandate determinations.	Fiscal disincentive could encourage timely participation by parties. It may also increase the State's liability to local entities.
Post-mandate processes	Local entities have little accountability to perform mandated activities effectively.	Convert mandated activities to funding sources, such as block grants or categorical programs, administered by state agencies.	This method could reduce administrative hurdles and improve coordination with broader policy objectives while maintaining performance by a majority of local entities.
	Some mandates represent permanent solutions to temporary problems.	Implement sunset reviews to force periodic review of individual mandates.	Sunset provisions allow the Legislature to reexamine the need for mandates and their costs.
	There is no current mechanism in place to have the Commission reconsider past mandate decisions to reflect recent legal opinions, federal law, or other factors.	Establish a process allowing interested parties to request that the Commission amend its test claim decisions upon a showing that there has been a subsequent change based on new or different facts, circumstances, or mandate laws.	A reconsideration process could promote state and local entities' confidence in the mandate process by assuring that mandates reflect current legal opinions, federal law, and other factors.
Other	Commission membership is dominated by representatives of the State.	Recast the membership of the Commission to include more local entity appointees.	Some believe more local representation would ensure that all perspectives are weighed equally before decisions are rendered.

Sources: Annual Legislative Analyst's Office budget analyses; Department of Finance's *Report on Evaluation of Current Mandates Reimbursement Process* (March 2006); the Center for Collaborative Policy, California State University, Sacramento's *Assessment Report Reforming the Mandate Reimbursement Process* (April 2006); consultants assisting local entities; and Minnesota Office of the Legislative Auditor, *State Mandates on Local Governments* (January 2000).

Note: Proposed reforms and potential considerations may summarize similar ideas from a number of sources.

In the pre-mandate period, before the Commission becomes involved in determining whether a mandate exists, problems can arise when the Legislature establishes new required activities for local entities. This may be done without effective evaluation of the potential breadth or cost of the activities. As discussed in Chapter 1, the actual costs of mandated activities can vary substantially from initial estimates. This indicates a possible void in the Legislature's understanding of what activities and costs a new program or higher level of service will entail and of differences in how local entities perform mandated activities. Table 3 presents three solutions intended to shed more light on new activities and their costs.

The first solution proposes the creation of a mandate cost committee to review proposed new local programs being considered during the legislative process. Importantly, the committee would include representatives from local entities who could add perspective on potential costs and the difficulty of implementing specific activities. The second recommends the use of pilot programs in selected locations. Pilot programs offer the chance to test a program on a limited basis and to adjust required activities for unforeseen problems. Real-world implementation also potentially provides a better idea of what a program will actually cost. The third reform idea proposes a fiscal disincentive to parties that delay the test claim process beyond the statutory time frame. For example, an interest penalty could be imposed for delaying the process beyond the required deadline.

In the post-mandate period, after the Commission has reported a new mandate and its estimated cost, problems can arise due to the lack of state control of mandate activities undertaken by local entities and the tendency for programs to diverge from original intentions or lose their usefulness over time. The first post-mandate reform idea presented in Table 3 recommends converting some mandates to funding sources such as block grants or categorical programs. Such change, which would require a legislative modification, would cause the affected mandate to come under the management of a state agency and presumably improve coordination between mandated activities and other broader policies. It could also relieve local entities of some of the administrative challenges associated with mandates.

The second reform proposes the sunseting of each mandate. This would force the reassessment of mandate activities and costs, hopefully leading to the modifications needed to keep worthy activities on track or to eliminate mandates that have outlived their usefulness. The third idea recognizes the need to update mandate programs in light of new laws and court decisions that could raise questions about a mandate's reimbursable activities or validity. Updating mandates regularly could maintain compliance

Pilot programs offer the chance to test a program on a limited basis and to adjust required activities for unforeseen problems.

with current laws and decisions, as well as bolstering trust in the mandate process. We discuss the need for a reconsideration process in the previous section.

Finally, some local entities believe that the composition of the Commission and the manner in which local representatives are appointed causes Commission decisions to be skewed in favor of the State. Currently, only two of the seven Commission members are required to come from local entities, and the governor appoints both of these members. Proponents of recasting Commission membership believe that having more local membership and perhaps having the Legislature appoint a certain number of local members would ensure that all perspectives are weighed equally before decisions are rendered.

Our assessment of current state mandate issues has led the Bureau of State Audits (bureau) to add the areas of mandate determination and payment to its list of high-risk issues. The length of time that elapses before the Commission decides whether a mandate exists and, if so, estimates accumulated costs, and the large and growing mandate liability are of concern to local entities throughout California and to the State itself. Thus, to the extent that resources are available, the bureau will continue to monitor the progress of the Commission in reducing its work backlog, the level of the State's liability, and the status of recent and future reforms intended to improve the mandate process.

Recommendations

To promote the legislatively determined, joint, and Commission processes and to provide the necessary information to assess their success, the following actions should occur:

- The Commission should add additional information in its semiannual report to inform the Legislature about the status of mandates being developed under joint and Commission processes, including delays that may be occurring. If the Commission believes it needs a statutory change to implement this recommendation, it should seek it.
- The Commission and Finance should inform local entities of these processes by making information about the alternatives readily available on their Web sites.

The Commission should continue its efforts to work with the legislative subcommittee and other relevant parties to establish a reconsideration process that will allow mandates to undergo revision when appropriate.

To improve the state mandate process, the Legislature, in conjunction with relevant state agencies and local entities, should ensure the further discussion of reforms.

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, CPA
State Auditor

Date: October 15, 2009

Staff: Karen L. McKenna, CPA, Audit Principal
Jim Sandberg-Larsen, CPA, CPFO
Christopher P. Bellows
Katie Tully
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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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Appendix

PRIOR AUDIT FINDINGS, RECOMMENDATIONS, AND CORRECTIVE ACTIONS

The Bureau of State Audits previously reviewed several issues regarding the Commission on State Mandates (Commission) during two audits issued in 2002 and 2003. The following tables show findings and recommendations presented in the reports as well as the corrective actions taken by the Commission and other parties.

In March 2002 we issued Report 2001-120, *School Bus Safety II: State Law Intended to Make School Bus Transportation Safer is Costing More than Expected* after the Joint Legislative Audit Committee (audit committee) requested that we examine claims under the School Bus Safety II mandate.

In October 2003 we issued Report 2003-106, *State Mandates: The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process* after the audit committee asked us to review California’s state mandate process along with local entity claims submitted under the Peace Officers Procedural Bill of Rights. Additionally, we reviewed the Animal Adoption mandate.

Table A.1
School Bus Safety II Mandate—Report 2001-120

FINDINGS	RECOMMENDATIONS	CORRECTIVE ACTIONS	STATUS
Guidance by the Commission on State Mandates’ (Commission) does not provide sufficient clarity to ensure that school districts claim reimbursement for mandated activities in an accurate and consistent manner. The lack of clarity appears to be the result of several factors, including the broad language in the statutes from which the parameters and guidelines (guidelines) were developed. In addition, the test claim process does not require the claimant to be specific when identifying activities to be reimbursed.	Legislators should amend the guidelines through legislation to more clearly define activities that are reimbursable and to ensure that those activities reflect what the Legislature intended. The guidelines should clearly delineate between activities that are required under prior law and those that are required under the mandate.	On September 30, 2002, the governor approved Assembly Bill 2781 (Chapter 1167, Statutes of 2002), which required the Commission to specify that costs associated with implementation of transportation plans were not reimbursable claims. In February 2004 a court found that state law did not impose a mandate, and in March 2004 the Commission set aside the statement of decision and guidelines for School Bus Safety II.	●
School districts’ interests appear to have been better represented in the process than the State’s, and this situation may have contributed to the ambiguity on this issue.	To ensure representation of the State’s interests, the Commission should ensure that all relevant state departments and legislative fiscal committees be given the opportunity to provide input on test claims and guidelines.	Commission staff implemented new procedures to increase the opportunity for state agencies and legislative staff to participate in the mandates process; notify relevant parties of proposed statements of decision, guidelines, and statewide cost estimates; and follow up with entities that are late in commenting on claims.	●

continued on next page...

FINDINGS	RECOMMENDATIONS	CORRECTIVE ACTIONS	STATUS
Most school districts we reviewed lacked sufficient documentation for their costs.	The Commission should work with the State Controller's Office (Controller), other affected state agencies, and interested parties to make sure the language in the guidelines and the claiming instructions reflects the Commission's intentions as well as the Controller's expectations regarding supporting documentation.	In January 2003 the Commission adopted text reflecting its intentions and the Controller's expectations regarding supporting documentation. It included this text in the guidelines for subsequent mandates it determined. Because it was waiting for litigation to be resolved, the Commission only recently developed a plan to address the Controller's 2006 request to include this text in the guidelines of mandates that existed before 2003. We discuss this issue further in chapters 1 and 2.	◐
The Commission did not identify the true fiscal impact of the mandate until three years after the law was passed. Although the Commission is required to follow a deliberate and often time-consuming process, it may have been able to avoid a delay of more than 14 months.	The Commission should ensure that it carries out its process for deciding test claims, approving guidelines, and developing the statewide cost estimate for mandates in as timely a manner as possible.	In March 2003 Commission staff indicated they implemented new procedures to ensure carrying out their process in as timely a manner as possible. We reviewed backlogs and processing times at the Commission, however, and found growing problems with delays. See Chapter 1 for further details.	◐
Commission staff believed that waiting for actual reimbursement claims and using the data to create statewide costs for the mandate results in more accurate estimates. However, they had not sought changes to the regulations to include sufficient time for obtaining the claims data.	If the Commission believes it necessary to use actual claims data when developing the statewide cost estimate, it should consider seeking regulatory changes to the timeline to include the time necessary to obtain the data from the Controller.	The Commission adopted regulations to incorporate the current methodology for developing statewide cost estimates, which allows for sufficient time for obtaining data. The methodology appears in guidelines for each mandate.	●

Sources: The Bureau of State Audits' prior reports to legislative subcommittees on the status of audits, state law and regulations, and information from the Commission and the Controller.

- = Full implementation.
- ◐ = Partial implementation.

Table A.2
Peace Officers Procedural Bill of Rights and Animal Adoption Mandates—Report 2003-106

FINDINGS	RECOMMENDATIONS	CORRECTIVE ACTIONS	STATUS
Local entities claimed reimbursement for questionable activities under the Peace Officers Procedural Bill of Rights (Peace Officer Rights) mandate. The primary factor contributing to this condition was that the entities and their consultants broadly interpreted guidance by the Commission on State Mandates (Commission) to claim reimbursement for large portions of their disciplinary processes, which the Commission clearly did not intend.	The State Controller's Office (Controller) should audit the claims already paid, giving particular attention to the types of problems described in our report.	The Controller initiated audits of the Peace Officer Rights claims. We reviewed the Controller's overall audit efforts as part of the scope of this report and found that local entities continue to have problems supporting their claims, including those for the Peace Officers Rights mandate. See Chapter 2 for the results of our review.	●
Local entities did not appear to look at the statement of decision or the formal administrative record surrounding the adoption of the statement of decision for guidance when they developed their claims.	The Commission should include language in its guidelines to notify claimants and the relevant state entities that the statement of decision is legally binding on all parties and provides the legal and factual basis for the guidelines. It also should point out that the support for such legal and factual findings is found in the administrative record of the test claim.	Commission staff developed language to implement our recommendation for inclusion in all new guidelines. According to staff, this development occurred in 2005.	●
In varying degrees, claimants under the Peace Officer Rights and Animal Adoption mandates lacked adequate support for their costs and inaccurately calculated claimed costs. For example, local entities claiming under the Peace Officer Rights mandate based the amount of time they claimed on interviews and informal estimates developed after the related activities were performed instead of recording the actual staff time spent on reimbursable activities or developing an estimate based on an acceptable time study.	<p>The Controller should issue guidance on what constitutes an acceptable time study for estimating the amount of time employees spend on reimbursable activities and under what circumstances local entities can use time studies.</p> <p>Local entities that have filed, or plan to file, claims for reimbursement under the Peace Officer Rights or Animal Adoption mandate should consider carefully the issues in our report to ensure that they submit claims that are for reimbursable activities and should refile claims when appropriate.</p>	<p>The Controller indicated that it developed draft time-study guidelines in consultation with representatives of local governments and their consultants and provided them to interested state agencies for comment in March 2004. The Controller published time-study guidelines in January 2005.</p> <p>Our review of the Controller's audit efforts indicates that local entities continue to have problems supporting their claims. See Chapter 2 for the results of our review.</p>	●
For the Animal Adoption mandate, the Commission's formula for determining the reimbursable amount of the costs of new facilities does not isolate how much of a claimant's construction costs relate to holding animals for a longer period of time.	We recommended that the Legislature direct the Commission to amend the guidelines of the Animal Adoption mandate to correct the formula for determining the reimbursable portion of acquiring additional shelter space.	Legislators added a statute requiring the Commission to amend the formula for determining the reimbursable portion of acquiring or building additional shelter space. The Controller submitted a suggested guidelines amendment to clarify reimbursements related to acquiring additional space. The Commission amended the guidelines for this mandate in 2006 to reflect these changes.	●
The definition of average daily census in the Animal Adoption mandate guidelines could be clearer. In fact, one local entity understated its annual census of dogs and cats by including only strays in the figure, instead of including all dogs and cats.	The Controller should amend the claiming instructions or seek an amendment to the Animal Adoption mandate guidelines to emphasize that average daily census must be based on all animals housed to calculate reimbursable costs properly under the care and maintenance section.	The Controller submitted to the Commission a suggested guidelines amendment to clarify calculation of the average daily census and the documentation requirements for new animal shelters. The Commission adopted these changes in 2006.	●

Sources: The Bureau of State Audits' prior reports to legislative subcommittees on the status of audits, state law and regulations, and information from the Commission and the Controller.

- = Full implementation.
- ◐ = Partial implementation.

Table A.3
Other Issues—Report 2003-106

FINDINGS	RECOMMENDATIONS	CORRECTIVE ACTIONS	STATUS
The mandate process does not afford the State Controller's Office (Controller) an opportunity to perform a field audit of the claims for new mandates early enough to identify potential problems.	The Commission on State Mandates (Commission) should work with the Controller, other affected state agencies, and interested parties to implement appropriate changes to the regulations governing the mandate process, allowing the Controller sufficient time to perform these field audits and to identify any inappropriate claiming as well as to suggest any needed changes to the guidelines before development of the statewide cost estimate and payment of claims.	Our review of the Controller's efforts found that sometimes the Controller now performs audits before it pays claims. Also, for a limited number of mandates we reviewed, it performed audits closer to, and sometimes before, publication of the Commission's statewide cost estimates.	●
Inherent limitations in the process the Commission uses to develop statewide cost estimates for new mandates result in underestimates of mandate costs. Commission staff base statewide cost estimates for mandates on the initial claims local entities submit to the Controller, but these entities are allowed to submit late or amended claims long after the Commission adopts its estimate.	Commission staff should analyze more carefully the completeness of the initial claims data used to develop statewide cost estimates and adjust the estimates accordingly. Additionally, the Commission should disclose the incomplete nature of the initial claims data when reporting to the Legislature.	Our review of recent statewide cost estimates for five large programs found that on the whole they were close to actual approved claims. In addition, the Commission's reports to the Legislature disclose the incomplete nature of the data used to develop the estimates. See Chapter 1 for details.	●
Commission staff assert that lack of staffing will continue to affect the Commission's ability to meet statutory deadlines related to the mandate process.	The Commission should continue to assess its caseload and work with the Department of Finance (Finance) and the Legislature to obtain sufficient staffing to ensure that it is able to meet its statutory deadlines in the future.	Commission staff reported in 2004 that, on an ongoing basis, they would submit budget change proposals to Finance for additional resources that support the Commission's caseload. In addition, beginning in 2006 the Commission is required to submit annually a report on workload levels and backlogs to Finance. The Commission gained two additional legal positions in fiscal year 2005–06; however, it subsequently lost two legal positions. In addition, it has had some problems with filling its vacant positions. See Chapter 1 for further details.	◐

Sources: The Bureau of State Audits' prior reports to legislative subcommittees on the status of audits, state law and regulations, and information from the Commission and the Controller.

● = Full implementation.

◐ = Partial implementation.

(Agency response provided as text only.)

Commission on State Mandates
980 Ninth Street, Suite 300
Sacramento, CA 95814

September 25, 2009

Ms. Elaine M. Howle,
State Auditor
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Re: Response to Bureau of State Audits' Draft Report, 2009-501
State Mandates: Operational and Structural Changes Have Yielded Limited Improvements in
Expediting Processes and Controlling Costs and Liabilities

Dear Ms. Howle:

Thank you for the opportunity to respond to the Bureau of State Audits' Draft Report, "State Mandates: Operational and Structural Changes Have Yielded Limited Improvements in Expediting Processes and Controlling Costs and Liabilities." We appreciate your accurate description of the mandate reimbursement process and the Commission's quasi-judicial role in it. Following are our responses to the specific recommendations in the report that relate to the Commission.

Chapter 1 Recommendations

To ensure that it sufficiently resolves its backlog of test claims, incorrect reduction claims, and the boilerplate amendment request, the Commission should do the following:

- *Work with Finance to seek additional resources to reduce its backlog, including test claims and incorrect reduction claims. In doing so, Commission staff should prioritize its workload and seek efficiencies to the extent possible.*
- *Implement its work plan to address the Controller's boilerplate amendment.*

Response: The Commission agrees with these recommendations.

As noted in the report, unless staffing is increased to effectively handle the caseload, especially the incorrect reduction claims, the backlog will continue to increase dramatically. The entire Commission staff consists of 10.5 positions and is severely outnumbered by the Controller's 33 auditors. As the State Controller continues to reduce reimbursement claims, we have no doubt that the number of incorrect reduction claims will continue to increase. Therefore, we will continue to work with the Department of Finance and the Legislature to address the Commission's staffing issues.

The Commission staff will work with the affected state agencies and claimant representatives to prioritize workload and identify efficiencies consistent with legislative and Commission intent. The staff will develop and propose appropriate changes to the regulations and statutes in consultation with affected state agencies and interested parties. Any changes to the Commission's regulations will be submitted to the

Ms. Elaine Howle
September 25, 2009
Page 2

Commission for approval and adoption. If it is necessary to seek appropriate statutory changes, a legislative proposal will be submitted to the Commission and the Governor's Office for approval prior to submission to the Legislature.

The Commission staff is implementing its work plan to complete the State Controller's request to amend 49 sets of parameters and guidelines to include boilerplate language. The Commission will begin hearing these parameters and guidelines in October 2009, and will complete hearings on this matter by March 2010.

Chapter 3 Recommendations

To promote the legislatively determined, joint, and Commission processes and to provide the necessary information to assess their success, the following actions should be taken:

- The Commission should add additional information in its semiannual report to inform the Legislature about the status of mandates being developed under joint and Commission processes, including delays that may be occurring. If the Commission believes it needs a statutory change to implement this recommendation, it should seek it.*
- The Commission and Finance should inform local entities of these processes by making information about the alternatives readily available on their Web sites.*
- The Commission should continue its efforts to work with the legislative subcommittee, and other parties to establish a reconsideration process that will allow mandates to be revised when appropriate.*

Response: The Commission recognizes the importance of completing test claim and parameters and guidelines determinations to provide policymakers with timely statewide cost estimates for mandated programs. Thus, we agree that the Commission should report additional information in the semiannual report to inform the Legislature about the status of all pending matters. The Commission agrees with the audit findings supporting this recommendation and will seek a statutory change to implement this recommendation.

The Commission agrees that information about the alternative processes (AB 1222) should be readily available on the Commission's Website. This recommendation will be implemented after consultation with claimant organizations and the Department of Finance.

The Commission has formed a legislative subcommittee to review staff's initial draft proposal and develop a legislative proposal to establish a reconsideration process. A workshop on staff's initial draft proposal will be held in October 2009. Once the proposal is finalized, a legislative proposal will be submitted to the Commission and the Governor's Office for approval prior to submission to the Legislature.

Sincerely,

(Signed by: Paula Higashi)

PAULA HIGASHI
Executive Director

(Agency response provided as text only.)

State Controller's Office
300 Capitol Mall, Suite 1850
Sacramento, CA 95814

September 28, 2009

Elaine M. Howle, CPA
State Auditor
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Re: Response to Bureau of State Audits' Draft Report on State Mandates

Dear Ms. Howle:

Thank you for the opportunity to respond to the Bureau of State Audits' Draft Report, "State Mandates: *Operational and Structural Changes Have Yielded Limited Improvements in Expediting Processes and Controlling Costs and Liabilities.*"

We are in agreement with all of your recommendations and will work with the Department of Finance to ensure that the maximum number of mandate claim audits can be performed.

Sincerely,

(Signed by: John Chiang)

JOHN CHIANG
California State Controller

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(Agency response provided as text only.)

Department of Finance
State Capitol, Room 1145
Sacramento, CA 95814-4998

September 28, 2009

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

Dear Ms. Howle:

The Department of Finance (Finance) has reviewed the Bureau of State Audit's draft report entitled, "State Mandates: Operational and Structural Changes Have Yielded Limited Improvements in Expediting Processes and Controlling Costs and Liabilities."

The audit makes one recommendation to the Department of Finance. The audit recommends Finance make information related to the alternative processes for mandate determinations and funding readily available on our website.

As your report shows, this information is already provided on the State Controller's Office website in the Frequently Asked Questions section of the mandates page. Local agencies are very familiar with the Controller's website; however, at the next Commission on State Mandates hearing, Finance will seek input from stakeholders about the value of adding the alternative process information to the Finance website.

If you have any questions, please contact Diana Ducay, Program Budget Manager at (916) 445-3274.

Sincerely,

(Signed by: Fred Klass for)

MICHAEL C. GENEST
Director

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