Implementation of State Auditor's Recommendations

Audits Released in January 2002 Through December 2003

Special Report to

Assembly Budget Subcommittee #4—State Administration

February 2004
Report No. 2004-406 A4

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CALIFORNIA STATE AUDITOR

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February 25, 2004 2004-406 A4

The Governor of California
Members of the Legislature
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its special report for the Assembly Budget Subcommittee No. 4—State Administration. This report summarizes the audits and investigations we issued during the previous two years that are within this subcommittee's purview. This report includes the major findings and recommendations, along with the corrective actions auditees reportedly have taken to implement our recommendations.

This information is also available in a special report that is organized by policy areas that generally correspond to the Assembly and Senate standing committees. This special policy area report includes appendices that summarize recommendations that warrant legislative consideration and monetary benefits that auditees could realize if they implemented our recommendations. This special policy area report is available on our Web site at www.bsa.ca.gov/bsa/reports/subcom2004-policy.html. Finally, we notify auditees of the release of these special reports.

Our audit efforts bring the greatest returns when the auditee acts upon our findings and recommendations. This report is one vehicle to ensure that the State's policy makers and managers are aware of the status of corrective action agencies and departments report they have taken. Further, we believe the State's budget process is a good opportunity for the Legislature to explore these issues and, to the extent necessary, reinforce the need for corrective action.

Respectfully Submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

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INTRODUCTION

This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2002 through December 2003, that relate to agencies and departments under the purview of the Assembly Budget Subcommittee No. 4—State Administration. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol ➲ in the left-hand margin of the auditee action to identify areas of concern or issues that we believe an auditee has not adequately addressed.

For this report, we have relied upon periodic written responses prepared by auditees to determine whether corrective action has been taken. The Bureau of State Audits' (bureau) policy requests that auditees provide a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow-up, we request the auditee to respond at least three times subsequently: at 60 days, six months, and one year after the public release of the audit report. However, we may request an auditee provide a response beyond one year or initiate a follow-up audit if deemed necessary.

We report all instances of substantiated improper governmental activities resulting from our investigative activities to the cognizant state department for corrective action. These departments are required to report the status of their corrective actions every 30 days until all such actions are complete.

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of February 2, 2004.

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STATE BAR OF CALIFORNIA

Although It Reasonably Sets and Manages Mandatory Fees, It Faces Potential Deficits in the Future and Needs to More Strictly Enforce Disciplinary Policies and Procedures

REPORT NUMBER 2002-030, APRIL 2003

The State Bar of California response as of October 2003

Audit Highlights . . .

The State Bar of California (State Bar) continues to make some improvements since our audit in 2001. For example, it:

- ☑ *Made further changes to reduce its backlog of disciplinary cases.*
- ☑ *Continued to ensure that mandatory fees are reasonable and do not support voluntary programs.*

However, the State Bar needs to do the following:

- ☑ *Ensure that policies and procedures for processing disciplinary cases are being followed.*
- ☑ *Monitor its need for an increase in membership fees to avoid a potential deficit in its general fund in the future.*

Chapter 342, Statutes of 1999, directed the State Bar of California (State Bar) to contract with the Bureau of State Audits to conduct a performance audit of the State Bar's operations from January 1, 2002, through December 31, 2002. We found that the State Bar continues to reduce its backlog of disciplinary cases that resulted from its virtual shutdown in 1998. Overall, the State Bar's efforts have significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002. In addition, the State Bar continues to ensure that dues for members are reasonable and are not used to support voluntary functions. However, deficiencies similar to those identified by the State Bar's staff in its 2000 internal random review of disciplinary cases continue to be an issue. Moreover, the State Bar's financial forecast indicates that if fees remain at its current level, the State Bar could face a deficit in its general fund at the end of 2005.

Finding #1: The State Bar has made significant progress in decreasing its backlog of disciplinary cases.

Since our 2001 audit, the State Bar has continued its efforts to decrease its backlog of disciplinary cases. For example, it created a backlog team in its enforcement unit. The backlog team, composed generally of the most experienced investigators, focused exclusively on the backlog cases. The overall goal for 2002 was to have a backlog of no more than 400 cases. The State Bar's efforts significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002. According to a backlog reduction report prepared by its staff, the State Bar is currently focusing on not allowing the backlog to increase beyond 400 in 2003. Further, it maintains an "aspirational goal" of reducing the backlog to 250 by the end of

2003, but the report stated that the State Bar's ability to achieve that goal has been negatively impacted by budget constraints and other external factors.

We recommended that the State Bar continue its efforts to reduce its current backlog.

State Bar Action: Partial corrective action taken.

The State Bar reported that it is continuing its efforts to reduce the backlog. In June 2003, it reported that the backlog had risen to 756. However, as of October 2003 the State Bar reduced it to 566 cases. The State Bar stated it maintains its goal of bringing the backlog back down to 400 by the end of 2003.

Finding #2: The State Bar needs to strictly enforce its policies and procedures when processing complaints.

The State Bar's internal random review process indicates that staff do not always follow policies and procedures when processing complaints. Specifically, in 2002, the State Bar identified some of the same type of deficiencies as reported in its random review in 2000. Its two reviews in 2002 identified staff's failure to enter information into the computer database, poor record keeping and file maintenance, and not sending closing letters to complainants or respondents. Because State Bar staff did not always provide proper record keeping and file maintenance, the reviewers sometimes found it difficult to determine if a case had been appropriately handled. However, the reviewers found that the areas of concern were not generally significant enough to have an adverse effect on the overall disposition of a case. To address some of these issues, the State Bar conducted group and individual training, and it issued a training bulletin to remind staff of the policies and procedures.

We recommended that the State Bar require that each file contain a checklist of important steps in the process and potential documents to ensure that employees follow policies and procedures for processing cases. Each applicable item should be checked off as it is performed or received. An employee's supervisor should be responsible for reviewing the checklists to ensure their use. In addition, the State Bar should conduct spot checks of current cases that are being closed. Responsible staff should be required to resolve any issues concerning files determined to be noncompliant.

State Bar Action: Partial corrective action taken.

The State Bar reported that it has implemented the use of checklists to ensure important steps are taken and necessary documents are contained in the files. It also has begun implementation of a computer verification system. This system does not allow a matter to be closed or forwarded unless the file is properly updated. In addition, the State Bar reported that it has postponed until November 2003 the implementation of having supervising attorneys in the Office of the Chief Trial Counsel spot-check closures every month to verify that files include closing letters and detailed closing memos. Instead, the State Bar performed a one-time, large-scale audit of cases closed in 2002. A full analysis of the results was to have been completed by the end of October 2003.

Finding #3: Cost recoveries for the State Bar's client security fund and disciplinary activities continue to be low.

Since our 2001 audit, the State Bar's cost recovery rates improved slightly, although the rates remain low. Specifically, the Client Security Fund cost recovery rates increased from 2.5 percent in 2000 to 10.9 percent in 2002. A similar increase occurred in the cost recovery rates from the disciplinary process. In 2002, these amounts increased from 28.8 percent to 36.4 percent. Because cost recoveries are still low, the State Bar used more of its membership fees to subsidize support for its Client Security Fund and disciplinary process than it might otherwise need to.

The State Bar believes that other recovery methods, such as the State's offset program, may not be feasible. One cost recovery method that may be available is the collection of money debts under the California Enforcement of Judgments Law. However, according to the executive director, the State Bar's position is that state statutes explicitly define the specific circumstances and methods by which it is to impose and collect its disciplinary costs, and thus the Legislature has implicitly excluded other methods more generally provided in the law.

When our audit report was issued in April 2003, the executive director told us that the State Bar was seeking a legislative amendment, similar to statutory language applicable to costs imposed in disciplinary proceedings of the Department of Consumer Affairs, to help it strengthen its collection enforcement authority. Because existing state law does not

explicitly state that the State Bar can use the methods provided in the Enforcement of Judgments Law, the State Bar believes it needs statutory language that states it can do so. This language would provide the State Bar independent authority to pursue legal action for these costs.

We recommended that the State Bar pursue a legislative amendment that would help it strengthen its enforcement authority over collections related to client security and disciplinary costs.

State Bar and Legislative Action: Corrective action taken.

The State Bar reported that on September 6, 2003, the governor approved Assembly Bill 1708 (AB 1708). Effective January 1, 2004, sections 6086.10(a) and 6140.5(d) of the Business and Professions Code will provide that court orders, which impose disciplinary costs or require the reimbursement of the Client Security Fund by attorneys who have been suspended, disbarred, or the subject of a public reproval, will be enforceable as a money judgment. The remedy will apply retroactively to all court orders imposing disciplinary costs or Client Security Fund reimbursements. The State Bar reported that these changes would permit it to obtain writs and abstracts of judgments and seek orders of examinations in the superior courts. In addition, the recording of abstract judgments would then typically be reflected in the reports of credit agencies. Further, the State Bar reported that it created a working group of staff to establish the processes and procedures necessary to implement these new statutes on the effective date of January 1, 2004.

Finding #4: Although it continues to ensure that mandatory fees are reasonable and do not support voluntary programs, the State Bar faces potential deficits in the future.

For the year 2002, the State Bar's financial records for the general fund indicate that it charged a reasonable level of fees. The general fund's revenues of $46.4 million exceeded its expenses by $2.5 million. However, because the board of governors approved transfers to other funds of $5.9 million, its general fund balance declined from $6.6 million in 2001 to $3.3 million in 2002. A financial forecast prepared by the State Bar predicts that in 2003 through 2007, if membership fees remain at $390 a year, general fund expenses will exceed its revenues. Although the State Bar's general fund balance is

expected to decrease as a result of its expenses increasing faster than its revenues, a deficit is not expected to occur until the end of 2005 because of the newly created Public Protection Reserve Fund. As of January 1, 2001, the State Bar established this fund to provide a hedge against the unexpected and to assure continuity of its disciplinary system and other essential public protection programs. However, if State Bar expenses continue to exceed its revenues, a deficit in the combined available balance for the general fund and Public Protection Reserve Fund is anticipated by the end of 2005 that will continue to grow through 2007.

We recommended that the State Bar continue to monitor for the necessity of a fee increase to ensure that mandatory fees are set at a reasonable level to meet its operational needs.

State Bar Action: Partial corrective action taken.

In June 2003, the State Bar reported that because of the State's current fiscal situation it was seeking a one-year fee bill that would maintain mandatory dues at $390 for the 2004 billing year. The State Bar expected to rely on existing reserves to balance the general fund budget for 2004 and anticipated proposing a multi-year fee bill with a tiered fee increase that would support ongoing operations without relying on reserves. In October 2003, the State Bar reported that the 2004 general fund budget was balanced by transferring the revenue allocated to the Lawyer Assistance Program back to the general fund; enhancing member revenue by restricting eligibility for reduced fees for certain categories of members (member fee scaling); eliminating the general fund contribution to the Public Protection Reserve Fund; eliminating 16 positions; and reducing proposed non-personnel expenditures. The State Bar also reported that AB 1708 was signed in September 2003, authorizing it to collect up to $390 per member in annual membership fees for 2004. This authorization maintains the same fee level in effect since 2001. AB 1708 also amends existing statute to restrict eligibility for member fee scaling and allows the State Bar to enforce the collection of disciplinary costs incurred in the general fund and reimbursements to the Client Security Fund as money judgments to be included in an individual's membership fee. The State Bar is hopeful this legislation will provide additional funding and ease pressure to increase member fees. Finally, the State Bar reported that it would continue to review its operations for improvements in efficiency, with staff reductions, as appropriate.

SCHOOL BUS SAFETY II

State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected

REPORT NUMBER 2001-120, MARCH 2002

The Commission on State Mandates response, State Controller's Office response, and most school district responses as of March 2003[1]

Audit Highlights . . .

Our review of the School Bus Safety II mandate found that:

- ☑ *The costs for the mandate are substantially higher than what was initially expected.*
- ☑ *The costs claimed by seven school districts varied significantly depending upon the approach taken by their consultants.*
- ☑ *The different approaches appear to result from the lack of clarity in the guidelines adopted by the Commission on State Mandates (commission).*
- ☑ *Most of the school districts we reviewed lacked sufficient support for the amounts they claimed.*
- ☑ *The commission could have avoided delays totaling more than 14 months when determining whether a state mandate existed and in developing a cost estimate.*

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits examine the claims under the School Bus Safety II mandate. Specifically, we were asked to review the Commission on State Mandates' (commission) guidelines to determine if they adequately define the mandate's reimbursable activities and provide sufficient guidance for claiming reimbursable costs. In addition to examining any prior reviews of the claims, we were asked to examine a sample of claims to determine if the costs met the criteria for reimbursement. Finally, the audit committee asked us to evaluate the commission's methodology for estimating the future costs of this mandate.

Finding #1: The commission's guidance regarding claims reimbursement lacks clarity.

The guidance issued by the commission does not provide sufficient clarity to ensure that school districts claim reimbursement for mandated activities in an accurate and consistent manner. Instead, the guidance established a broad standard that has allowed a variety of interpretations by school districts as to what costs to claim. The lack of clarity in the guidance appears to be the result of several factors, including the broad language in the statutes from which the guidelines were developed. In addition, the test claim process does not require the claimant to be specific when identifying activities to be reimbursed. Further, the commission's executive director states that the commission, as a quasi-judicial body, is limited in making changes to the guidelines. Finally,

[1] School districts responding to the audit were Ceres Unified School District, Dinuba Unified School District, Elk Grove Unified School District (Elk Grove), Fresno Unified School District, and San Dieguito Union High School District. Elk Grove's response was as of October 2002.

the fact that the school districts' interests appear to have been better represented in the process than the State's also may have contributed to the ambiguity on this issue.

We recommended the Legislature amend the parameters and 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. To ensure that the State's interests are fully represented in the future, we recommended the commission ensure that all relevant state departments and legislative fiscal committees be provided with the opportunity to provide input on test claims and parameters and guidelines. Further, we recommended the commission follow up with entities that have indicated they would comment, but did not. Finally, we recommended that the commission notify all relevant parties, including legislative fiscal committees, of the decisions made at critical points in the process, such as the test claim statement of decision, the adoption of the parameters and guidelines, and the adoption of the statewide cost estimate.

Legislative Action: Legislation passed.

On September 30, 2002, the governor approved Assembly Bill 2781 (Chapter 1167, Statutes of 2002). This new law requires the commission to specify that costs associated with implementation of transportation plans are not reimbursable claims and requires the amended parameters and guidelines to be applied retroactively as well as prospectively.

Commission Action: Corrective action taken.

In January 2003, the commission amended the parameters and guidelines as outlined in Chapter 1167, Statutes of 2002. Additionally, 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, parameters and guidelines, and statewide cost estimates; and follow up with entities that are late in commenting on claims. For example, in addition to a letter initially inviting state agency participation, commission staff now send a letter notifying all parties of the tentative hearing dates for each test claim. Additionally, they send e-mail notices of release of analyses of test claims, proposed parameters and guidelines, statewide

cost estimates, and proposed statements of decision to fiscal and policy committee staff. Further, commission staff contact state agencies, claimants, and other relevant parties when comments are late.

Finding #2: Most school districts we reviewed lacked sufficient documentation for their costs.

We found that many school districts did not maintain sufficient documentation to support their claims. In fact, of the more than $2.3 million total direct costs the seven districts we reviewed submitted for reimbursement in fiscal year 1999–2000, only $606,000 (26 percent) was traceable to documents that sufficiently quantified the costs. To support the remaining $1.7 million (74 percent), these school districts relied substantially upon incomplete supporting data. School districts are to follow the parameters and guidelines issued by the State Controller's Office (Controller) when claiming reimbursement under the mandate. The districts asserted they had sufficient support, yet the documentation we reviewed lacked crucial elements, such as corroborating data, and failed to substantiate the amounts claimed for reimbursement in many instances. In addition, some school districts claimed amounts for time increases to complete school bus routes, yet they failed to maintain corroborating evidence to support these increases. Further, one district based much of the costs it claimed on questionable assumptions and even claimed for activities that appear to be beyond the scope of the mandate. Only San Diego City Unified School District had support for all the $5,171 in direct costs it claimed. Additionally, San Jose Unified School District had sufficient documentation to support nearly all the $590,000 in direct costs that it claimed.

School districts should ensure that they have sufficient support for the costs they have claimed. In addition, the commission should work with the 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.

School District Action: Partial corrective action taken.

Ceres Unified School District, Dinuba Unified School District, and Fresno Unified School District conducted time studies to support costs associated with the mandate. San Dieguito Union High School District has taken steps to ensure that its claimed activities are supported by sufficient documentation, including ensuring that it properly maintains training records in its computer system. Elk Grove Unified School District previously stated that when the commission came out with new rules, regulations, and guidelines regarding the mandate, it would follow them.

Commission Action: Corrective action taken.

Commission staff worked with the Controller and others to amend existing parameters and guidelines and adopt new parameters and guidelines that reflected its intention and the Controller's expectations regarding supporting documentation. In January 2003, the commission adopted the Controller's proposed language, as modified by commission staff, that requires claimants to maintain documentation developed at or near the time actual costs were incurred in order to support their reimbursement claims. The commission intends to address the language in all future parameters and guidelines, and in existing parameters and guidelines as they are amended.

Finding #3: The commission did not identify the true fiscal impact of the mandate until three years after the law was passed.

The Legislature was not aware of the magnitude of the fiscal impact of its action when it passed the 1997 law that comprises the majority of the School Bus Safety II mandate. Three different entities that analyzed the 1997 law before its passage believed that it would not be a state mandate and thus the State would not have to reimburse the districts' costs. Further, these entities advised the Legislature that annual costs would be no more than $1 million, considerably less than the $67 million in annual costs that the commission is now estimating. This misperception of the likely costs prevailed until January 2001, when the commission finally released a statewide cost estimate. Although the commission is required to follow a deliberate and often time-consuming process when determining whether a test claim is a

state mandate and adopting a statewide cost estimate, it appears that it could have avoided a delay of more than 14 months. Consequently, the Legislature did not have the information necessary to act promptly to resolve the issues of possible concern previously discussed in this report. Finally, commission staff believe that waiting for actual reimbursement claims reported to the Controller and using this data to estimate statewide costs for the mandate results in more accurate estimates. However, commission staff have not sought changes to the regulations to include sufficient time for waiting for the claim data.

We recommended the commission ensure that it carries out its process for deciding test claims, approving parameters and guidelines, and developing the statewide cost estimate for mandates in as timely a manner as possible. 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.

Commission Action: Corrective action taken.

Commission staff implemented new procedures to ensure that it carries out its process in as timely a manner as possible. Specifically, they now propose statewide cost estimates for adoption approximately one month after they receive initial reimbursement claims data from the Controller. They also close the record of the claim and start their staff analysis if claimant responses are not submitted timely. Claimants who choose to rebut state agency positions at a later time may provide rebuttal comments to the draft staff analysis. Further, the commission initiated a rulemaking package in February 2003 to incorporate the current methodology for developing statewide cost estimates into the commission's regulations.

STATE MANDATES

The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process

Audit Highlights . . .

Our review of the Peace Officers Procedural Bill of Rights (peace officer rights) and the animal adoption mandates found that:

- ☑ *The costs for both mandates are significantly higher than what the Legislature expected.*
- ☑ *The local entities we reviewed claimed costs under the peace officer rights mandate for activities that far exceed the Commission on State Mandates' (Commission) intent.*
- ☑ *The local entities we reviewed lacked adequate supporting documentation for most of the costs claimed under the peace officer rights mandate and some of the costs claimed under the animal adoption mandate.*
- ☑ *Structural reforms are needed to afford the State Controller's Office an opportunity to perform a field review of initial claims for new mandates early enough to identify potential problems.*
- ☑ *Commission staff have indicated that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future due to an increase in caseload and a decrease in staffing.*

REPORT NUMBER 2003-106, OCTOBER 2003

Commission on State Mandates' and State Controller's Office's responses as of December 2003[1]

The Joint Legislative Audit Committee asked the Bureau of State Audits to review California's state mandate process and local entity claims submitted under the Peace Officers Procedural Bill of Rights (peace officer rights) and animal adoption mandates. Our review found that the costs for both mandates are significantly higher than what the Legislature initially expected. In addition, we found that the local entities we reviewed claimed costs under the peace officer rights mandate for activities that far exceeded the Commission on State Mandates' (Commission) intent. Further, claimants under both mandates lacked adequate supporting documentation and made errors in calculating costs claimed.

The problems we identified highlight the need for some structural reforms of the mandate process. Specifically, the mandate process does not afford the State Controller's Office (Controller) the opportunity to perform a field review of the first set of claims for new mandates early enough to identify potential claiming problems. In addition, the Commission could improve its reporting of statewide cost estimates to the Legislature by disclosing limitations and assumptions related to the claims data it uses to develop the estimates. Finally, Commission staff have indicated that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future due to an increase in caseload and cutbacks in staffing. Specifically, we found:

Finding #1: Local entities claimed reimbursement for questionable activities under the peace officer rights mandate.

We question a large portion of the costs claimed by four local entities that received $31 million of the $50 million paid under the peace officer rights mandate, and we are concerned that

[1] City of Los Angeles, San Francisco, San Jose, Los Angeles County, and San Diego County responses as of January 2004.

the State already may have paid more than some local entities are entitled to receive. In particular, we question $16.2 million of the $19.1 million in direct costs that four local entities claimed under the peace officer rights mandate for fiscal year 2001–02 because they included activities that far exceed the Commission's intent. Although we noted limited circumstances in which the Commission's guidance could have been enhanced, the primary factor contributing to this condition was that local entities and their consultants broadly interpreted the Commission's guidance to claim reimbursement for large portions of their disciplinary processes, which the Commission clearly did not intend. We also noted that the local entities we reviewed 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.

We recommended that, to ensure local entities have prepared reimbursement claims for the peace officer rights mandate that are consistent with the Commission's intent, the Controller audit the claims already paid, paying particular attention to the types of problems described in our report. If deemed appropriate based on the results of its audit, the Controller should request that the Commission amend the parameters and guidelines to address any concerns identified, amend its claiming instructions, and require local entities to adjust claims already filed. The Controller should seek any statutory changes needed to accomplish the identified amendments and to ensure that such amendments can be applied retroactively.

We also recommended that, to assist local entities in preparing mandate reimbursement claims, the Commission include language in its parameters and 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 parameters and 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.

Further, we recommended that all local entities that have filed, or plan to file, claims for reimbursement under the peace officer rights mandate consider carefully the issues raised in our report to ensure that they submit claims that are for reimbursable activities. Additionally, they should refile claims when appropriate. Finally, if local entities identify activities

they believe are reimbursable but are not in the parameters and guidelines, they should request that the Commission consider amending the parameters and guidelines to include them.

Controller Action: Partial corrective action taken.

The Controller reports that it has developed an audit program and initiated audits of the peace officer rights claims. In addition, the Controller indicates that it has met with Commission staff regarding a legislative proposal to allow retroactive claiming when amendments are made to reduce existing parameters and guidelines.

Commission Action: Corrective action taken.

Commission staff report that they have developed language to implement our recommendation for inclusion in all new parameters and guidelines adopted on or after December 3, 2003.

Local Entities Action: Pending.

The city of Los Angeles reports that it is working with its consultant and the Controller to clarify what activities are subject to reimbursement. It will then take appropriate action based on that information. Los Angeles County reports that it is revising its fiscal year 2002–03 peace officer rights claim in light of our audit findings and the Controller's draft claiming instructions for conducting time studies. However, its 60-day response did not address revisions to claims it submitted for earlier years. The city and county of San Francisco (San Francisco) disagrees with our findings related to the peace officer rights mandate and believes that the activities it claimed are allowable because it considers them to be an integral part of investigation activities related to the peace officer rights process and reasonable and necessary to protect its peace officers' rights in these cases. Finally, although the city of Stockton (Stockton) indicated in its initial response to our report that it generally agrees with our recommendations and plans to file amended claims, it did not provide us a 60-day response to update its status.

Finding #2: In varying degrees, claimants under the peace officer rights and animal adoption mandates lacked adequate support for their costs and inaccurately calculated claimed costs.

We question $18.5 million of the $19.1 million in direct costs that four local entities claimed under the peace officer rights mandate because of inadequate supporting documentation.

The local entities 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.

Additionally, we noted several errors in calculations of costs claimed under the peace officer rights mandate. Although we generally focused on fiscal year 2001–02 claims, the largest error we noted was in the fiscal year 2000–01 claim of one local entity. It overstated indirect costs by about $3.7 million because it used an inflated rate and applied the rate to the wrong set of costs in determining the amount it claimed. We noted two other errors related to fiscal year 2001–02 claims involving employee salary calculations and claiming costs for processing cases that included those of civilian employees, resulting in a total overstatement of $377,000.

We also found problems with the animal adoption claims. The four local entities we reviewed could not adequately support $979,000 of the $5.4 million they claimed for fiscal year 2001–02. In some instances, this lack of support related to the amount of staff time spent on activities. In another instance, a local entity could not adequately separate the reimbursable and nonreimbursable costs it incurred under a contract with a nonprofit organization that provided shelter and medical services for the city's animals.

In addition, we noted numerous errors in calculations the four local entities performed to determine the costs they claimed under the animal adoption mandate for fiscal year 2001–02. Although these errors caused both understatements and overstatements, the four claims were overstated by a net total of about $675,000. Several errors resulted from using the wrong numbers in various calculations involving animal census data.

We recommended that the Controller 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.

We also recommended that all local entities that have filed, or plan to file, claims for reimbursement under the peace officer rights or animal adoption mandate consider carefully the issues raised in our report to ensure that they submit claims that are supported properly. Additionally, they should refile claims when appropriate.

Controller Action: Partial corrective action taken.

The Controller indicates that it has been meeting with representatives of local governments and local government organizations to review proposed time study guidelines.

Local Entities Action: Partial corrective action taken.

Five of the six local entities we reviewed provided us a 60-day response generally indicating that they had taken some action to correct errors and develop better documentation to support their claims. In particular, the cities of Los Angeles and San Jose and San Diego County indicated that they either have or plan to submit revised animal adoption claims for fiscal year 2001–02. In addition, the city of Los Angeles indicates that it corrected some errors in its peace officer rights claiming process, and San Francisco reports that it is working on developing and enhancing support for its peace officer rights claim. Further, Los Angeles County reports that it is revising its fiscal year 2002–03 peace officer rights claim in light of our audit findings and the Controller's draft claiming instructions for conducting time studies. However, none of the 60-day responses mentioned whether or not the entities plan to submit revised peace officer rights claims for fiscal year 2001–02. Finally, although Stockton indicated in its initial response to our report that it generally agrees with our recommendations and plans to file amended claims, it did not provide us a 60-day response to update its status.

Finding #3: The Commission's animal adoption guidance does not adequately require claimants to isolate reimbursable costs for acquiring space and its definition of average daily census could be clearer.

Although the guidance related to the animal adoption mandate generally is adequate, 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. The two local entities we audited that claimed costs for acquiring space in fiscal year 2001–02 used the current formula appropriately to prorate their construction costs. However, one of them needed space beyond that created by the mandate; as a result, the costs it claimed probably are higher than needed to comply with the mandate.

In addition, we found that 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 entity made

this mistake because it used a definition from an earlier section of the parameters and guidelines that limited the census number to strays. Although the parameters and guidelines could have been clearer by including a separate definition in the care of dogs and cats section of the guidance, we believe the context makes it clear that the total costs for *all* dogs and cats must be divided by a census figure including *all* dogs and cats to compute an accurate daily cost per dog or cat.

We recommended that the Legislature direct the Commission to amend the parameters and guidelines of the animal adoption mandate to correct the formula for determining the reimbursable portion of acquiring additional shelter space. If the Commission amends these parameters and guidelines, the Controller should amend its claiming instructions accordingly and require local entities to amend claims already filed.

In addition, we recommended that the Controller amend the claiming instructions or seek an amendment to the parameters and 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 of the parameters and guidelines.

Legislative Action: Legislation proposed.

The Legislature has introduced Assembly Bill 533, which would direct the Commission to amend the parameters and guidelines of the animal adoption mandate to correct the problem we identified. As of January 2004, the bill was being discussed in assembly committees.

Controller Action: Pending.

Although the Controller indicates in its 60-day response that it has met with Commission staff and Joint Legislative Audit Committee (JLAC) staff regarding legislative proposals to address our recommendations, the response did not specifically address our recommendation related to care and maintenance costs under the animal adoption mandate.

Finding #4: Structural reforms are needed to identify mandate costs more accurately and to ensure that claims reimbursement guidance is consistent with legislative and commission intent.

The problems we identified related to claims filed under the peace officer rights and animal adoption mandates highlight the need for some structural reforms of the mandate process. For example, it is difficult to gauge the clarity of the Commission's guidance and the accuracy of costs claimed for new mandates until claims are subjected to some level of field review. However, the mandate process does not afford the Controller an opportunity to perform a field review of the claims for new mandates early enough to identify potential claiming problems.

Also, inherent limitations in the process the Commission uses to develop statewide cost estimates for new mandates result in underestimates of mandate costs. Even though Commission staff base statewide cost estimates for mandates on the initial claims local entities submit to the Controller, these entities are allowed to submit late or amended claims long after the Commission adopts its estimate. The Commission could disclose this limitation in the statewide cost estimates it reports to the Legislature by stating what assumptions were made regarding the claims data. In addition, Commission staff did not adjust for some anomalies in the claims data they used to develop the cost estimate for the animal adoption mandate that resulted in an even lower estimate.

We recommended that the Controller perform a field review of initial reimbursement claims for selected new mandates to identify potential claiming errors and to ensure that costs claimed are consistent with legislative and Commission intent. In addition, the 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 reviews and identify any inappropriate claiming as well as to suggest any needed changes to the parameters and guidelines before the development of the statewide cost estimate and the payment of claims. If the Commission and the Controller find they cannot accomplish these changes through the regulatory process, they should seek appropriate statutory changes.

We also recommended that Commission staff 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.

Controller Action: Pending.

The Controller reports that it has met with Commission staff regarding a legislative proposal to change the statewide cost estimate process and make other structural reforms. The Controller also indicates that it has met with JLAC staff on proposed legislation for implementing several of our recommendations.

Commission Action: Partial corrective action taken.

Commission staff indicate that they have met with the Controller and plan to meet with other state agencies and interested parties to discuss implementation of our recommendations. In addition, staff report that they will seek regulatory or statutory changes as necessary based on these discussions. Further, Commission staff indicate that they have developed additional assumptions and revised the method for projecting future-year costs and for reporting statewide cost estimates to the Legislature.

Finding #5: Commission staff assert that lack of staffing will continue to affect the Commission's ability to meet statutory deadlines related to the mandate process.

Commission staff indicated that the Commission has developed a significant caseload and has experienced cutbacks in staffing because of the State's fiscal problems. As a result, staff state that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future. This will cause further delays in the mandate process in general, including determination of the potential cost of new mandates.

We recommended that the Commission continue to assess its caseload and work with the Department of Finance and the Legislature to obtain sufficient staffing to ensure that it is able to meet its statutory deadlines in the future.

Commission Action: Corrective action taken.

Commission staff report that, on an ongoing basis, they will submit budget change proposals to the Department of Finance for additional resources that support the Commission's caseload. In addition, staff will report caseload status to the Commission at each hearing and to relevant legislative committees upon request.

VACANT POSITIONS

Departments Have Circumvented the Abolishment of Vacant Positions, and the State Needs to Continue Its Efforts to Control Vacancies

REPORT NUMBER 2001-110, MARCH 2002

Department of Finance's response as of May 2003, State Controller's Office response as of March 2003, and Department of Mental Health's response as of November 2002

Audit Highlights . . .

Our review of vacant positions in the State disclosed that:

- ☑ *Although the Legislature amended state law to shorten the period a position can be vacant before it is to be abolished, the law's effectiveness is hindered by departments' efforts to preserve positions.*
- ☑ *The five departments we visited misused certain personnel transactions to circumvent the abolishment of vacant positions.*
- ☑ *Changes in state law have not completely addressed the reasons departments have lengthy vacancy periods in some positions.*
- ☑ *The Department of Finance performed two reviews and plans to continue monitoring vacant positions during the next two years, but has not established an ongoing monitoring program.*
- ☑ *A method to provide the Legislature with an up-to-date yet reliable count of vacancies still does not exist.*

The Joint Legislative Audit Committee requested the Bureau of State Audits review vacant positions in the State and the uses of funding associated with the positions. Our review found that, although the Legislature amended state law to shorten the period a position can be vacant before it is abolished, the law's effectiveness is hindered by the efforts of state departments to preserve positions. Additionally, the departments we reviewed used the funding from vacant positions to carry out their programs, in part, because certain costs have not been fully funded. Finally, the Department of Finance (Finance) performed two reviews and plans to continue monitoring vacant positions during the next two years, but has not established an ongoing monitoring program. Specifically, we found that:

Finding #1: The five departments we visited misused certain personnel transactions to circumvent the abolishment of vacant positions.

The policies and procedures related to "120" transactions, which are intended to legitimately move existing employees between positions, allow flexibility, require little documentation substantiating the need for the transactions, and are not closely monitored. Although the State's policies do not specifically preclude departments from performing these transactions to avoid having positions abolished, circumventing state law is not a reasonable use of this form of transaction. Nevertheless, our review of transactions at the five departments for a two-year period revealed that they initiated at least 440 (89 percent) of 495 transactions to avoid the abolishment of vacant positions. However, our findings should not be interpreted to mean that departments throughout the State performed 89 percent

of "120" transactions to preserve vacant positions, as we selected some transactions to review because the patterns of use appeared questionable.

Our analysis of "607" transactions at these same five departments revealed that they are also sometimes being misused, though not nearly as often as "120" transactions. Properly used, "607" transactions propose new positions, delete positions, or reclassify positions. However, the departments performed, on average, at least 22 percent of the transactions we analyzed to preserve positions. More controls exist for "607" transactions than for "120" transactions, but the State requires little external accountability for "607" transactions. As we found with "120" transactions, state policies do not specifically preclude the use of "607" transactions to preserve existing positions. However, circumventing state law is not a reasonable use for the transactions.

We recommended that Finance issue an explicit policy to prohibit the use of "120" and "607" transactions to preserve vacant positions from abolishment. Additionally, we recommended that the State Controller's Office (SCO) issue guidance to departments on processing these transactions consistent with the policy issued by Finance. Further, the SCO should periodically provide to Finance reports of such transactions. Finance should analyze the reports to identify potential misuses of the transactions and follow up with departments as appropriate. Departments should discontinue their practice of using "120" and "607" transactions to circumvent the abolishment of vacant positions.

Legislative, Finance, and SCO Action: Legislation passed and corrective action taken.

In September 2002 the governor approved Chapter 1124, Statutes of 2002, which amended Government Code, Section 12439, to prohibit departments from performing personnel transactions to circumvent the abolishment of vacant positions. As a result, Finance did not issue an explicit policy to prohibit the use of "120" and "607" transactions to preserve vacant positions from abolishment. In December 2002 the SCO issued guidance to departments on processing the transactions consistent with the amended statute. Further, the SCO provided reports of "120" transactions to Finance in November 2002 and March 2003, respectively, for Finance's analysis and review. The SCO plans to provide reports of "607" transactions to Finance in fiscal year 2003–04.

Finally, the five departments we visited reported to us they have taken actions to discontinue or minimize the use of "120" and "607" transactions to circumvent state law and, thus, ensure that the transactions are used for appropriate reasons.

Finding #2: Despite changes, state law allows some positions to remain vacant almost a year.

After the Legislature became concerned about the number of vacant positions in state government, it amended Government Code, Section 12439, in July 2000 to reduce to six months the period of vacancy before the SCO abolishes vacant positions. However, the amended law stipulates that the six months must occur in the same fiscal year. This allows positions that become vacant after January 1 to stay vacant for almost a year before being abolished. Based on current law, the SCO's system tracks the vacancies until June 30 and then starts recounting the six consecutive monthly pay periods on July 1. Thus, some positions could be preserved from abolishment as long as the SCO issued a payment for only two days, January 2 and December 31. Finance reported in January 2002 it plans to examine the feasibility of amending state law to allow the vacancy period to cross fiscal years. However, as Finance also reported, the SCO's 30-year-old position control system requires significant changes to track vacancies without regard to fiscal year. Finance plans to evaluate the potential cost to modify the SCO's system. Finance stated that if the cost is feasible, it will address the funding in spring 2002.

We recommended that Finance, in conjunction with the SCO, continue with its current plans to examine the costs associated with modifying the SCO's position control system to track vacancies across fiscal years. If Finance determines that the necessary system changes are feasible, it should seek to amend Government Code, Section 12439, to require that the six consecutive monthly pay periods for which a position is vacant before abolishment be considered without regard to fiscal year.

Legislative and SCO Action: Legislation passed and corrective action taken.

Chapter 1124, Statutes of 2002, amended state law to allow the six consecutive monthly pay periods to occur within one fiscal year or between two consecutive fiscal years. As a result, the SCO has made the necessary changes to its position control system and planned to implement the changes no later than June 2003.

Finding #3: The amended law has not resolved some of the underlying causes of vacancies.

Changes in state law have not resolved some of the reasons departments have positions with lengthy periods of vacancy. The law currently provides departments with only one circumstance to retain vacant positions and two circumstances to reestablish vacant positions. In particular, the hard-to-fill designation has not entirely solved the problem of departments' inability to fill some vacant positions. Additionally, departments stated that lengthy examination and hiring processes hinder their ability to fill positions within six months. Further, departments may maintain some vacant positions to absorb other costs not fully funded.

We recommended that Finance continue to work with departments and other oversight agencies to fully identify and address the issues that lead to positions being vacant for lengthy periods. Finance should then consider seeking statutory changes that provide it with the authority to approve the reestablishment of vacant positions in additional circumstances, including when delays in hiring and examination processes extend the time it takes to fill positions.

Legislative Action: Legislation passed and corrective action taken.

Chapter 1124, Statutes of 2002, amended Government Code, Section 12439, to provide Finance with the authority to approve the reestablishment of vacant positions when certain conditions existed during all or part of the six consecutive monthly pay periods. The conditions include when a hiring freeze is in effect, when a department has been unable to fill positions despite its diligent attempts, and when positions are determined to be hard-to-fill. Additionally, the amended statute authorizes the SCO to reestablish vacant positions when department directors certify that specific circumstances existed in the six consecutive months.

Finding #4: The SCO's system for identifying positions to be abolished cannot track a position reclassified more than once during the fiscal year and does not have the capability to account for "120" transactions performed to circumvent abolishment.

The tracking system the SCO uses is supposed to follow a position through subsequent reclassifications. Thus, if the combined vacancy period before and after the reclassification

is more than six consecutive pay periods, the SCO flags the reclassified position for potential abolishment. However, the SCO's system for identifying positions to be abolished has two significant limitations. First, it cannot track a position that is reclassified more than once during the fiscal year. This causes the SCO to have to manually research transactions, which increases the risk that transactions may be missed. Second, the system does not have the capability to account for the use of "120" transactions performed to circumvent the abolishment of vacant positions. Our review found that departments use "120" transactions extensively to preserve vacant positions, thus increasing the likelihood of the tracking system missing vacant positions that should be abolished.

We recommended that the SCO consider the feasibility of modifying its system for identifying positions to be abolished so it can track them through more than one reclassification. Additionally, as we discussed in Finding #1, we recommended that the SCO periodically provide to Finance reports of "120" transactions so that Finance can identify potential misuses of the transactions and follow up with departments as appropriate.

SCO Action: Corrective action taken.

The SCO stated it has completed modifications to its system to track five different position changes. In addition, it has twice provided to Finance reports of "120" transactions for Finance's analysis of potential misuses of the transactions.

Finding #5: The Department of Mental Health did not adhere to the established controls requiring it to seek external approval for certain "607" transactions.

The Department of Mental Health (Mental Health) did not submit two transactions to Finance, even though they involved reclassifications to positions above the minimum salary level required for Finance's approval. Mental Health believed one of these transactions did not need Finance's approval because it downgraded a position and the related salary. Nonetheless, Finance staff stated that both transactions needed its approval.

We recommended that Mental Health ensure that it submits for Finance's required approval all "607" transactions that involve a reclassification to positions above the specified minimum salary level.

Mental Health Action: Corrective action taken.

Mental Health stated it has submitted for Finance's review and approval the reclassifications involving positions above the specified minimum salary level.

Finding #6: Despite Finance's recent scrutiny of vacant positions, ongoing monitoring is needed.

Finance performed two reviews to address the Legislature's concerns about the number of vacant positions. The reviews recommended that certain departments eliminate or redirect 4,236 positions beginning in fiscal year 2000–01. Additionally, Finance recommended in its first report that the funding from the positions be reallocated to the departments for other program uses. In its second report, Finance did not identify the total amount of funding to be eliminated or reallocated. In January 2002, Finance stated that it plans to conduct further reviews in 2002 and 2003. However, no ongoing monitoring program has been established. Without a regular process to monitor vacant positions, data may not be available to enable the State's decision makers, including the Legislature, to make informed decisions.

To ensure that the State continues to monitor vacant positions and the associated funding, we recommended that Finance direct departments to track and annually report the uses of such funding. Additionally, Finance should continue to analyze the departments' vacant positions and uses of funds, recommend to what extent departments should eliminate vacant positions, and either eliminate or redirect the funding for the positions. Further, it should periodically report its findings to the Legislature to ensure that the information is available for informed decision making.

Finance Action: Corrective action taken.

Finance stated that the Budget Act of 2002, Section 31.60, directed it to abolish at least 6,000 positions from all positions in state government that were vacant on June 30, 2002. The section also authorized Finance to eliminate at least $300 million related to the abolished positions. The section further required Finance to report to the Legislature on the specific positions abolished. Finance reported in November 2002 that it abolished 6,129 positions and $300.4 million. However, our review of Finance's report

revealed that it included 560 public safety positions, representing $23.5 million in cost savings, that Section 31.60 excluded from abolishment. Additionally, we found errors that understated the abolished positions by 39 and cost savings by $6.7 million. Moreover, we could not determine whether the positions Finance abolished included any that had been eliminated by other provisions of law. Chapter 1023, Statutes of 2002, also directs Finance to abolish at least 1,000 vacant positions by June 30, 2004, and to report to the Legislature on the specific positions abolished.

Finding #7: Actual funding needs may be obscured because departments use funding from excess vacant positions to carry out their programs, in part, because certain costs have not been fully funded.

Our review at five departments found that they spent the funds budgeted from excess vacant positions for the higher costs of their filled positions, overtime, personal services contracts, and operating expenses. For example, the five departments in total spent the majority of their funding from excess vacant positions on the higher cost of filled positions, in part because of their efforts to hire in hard-to-fill classifications included such expenses as hiring above the minimum salary level and pay differentials. The departments told us, and Finance acknowledges, that the State typically has not augmented department budgets for increases in the cost of filled positions. Because certain program costs have not been fully funded, departments sometimes use funding from excess vacant positions to bridge the gap between their actual costs and their present funding levels.

To ensure that budgets represent a true picture of how departments manage their programs, we recommended that Finance continue to assess if common uses of funds resulting from vacant positions represent unfunded costs that should be reevaluated and specifically funded.

Finance Action: Corrective action taken.

Finance stated that the Budget Act of 2002, Section 31.70, authorized it to reinstate up to one-half the funding reduced by Section 31.60 for fiscal year 2002–03 appropriations to ensure that departments have sufficient levels of funding. As of April 1, 2003, Finance approved the reinstatement of $37.4 million in funding.

Finding #8: A method to provide reliable, up-to-date information about the number of vacant positions does not exist.

Legislators have expressed concerns because current point-in-time information on vacant positions from the SCO appears to show a substantially higher number of vacancies than those presented by Finance. The vacancy number that Finance presented is derived from past year actual information from other SCO reports. However, this number is generally not available until about five to six months after the end of the fiscal year. The SCO and Finance worked together to calculate a reliable, up-to-date number of vacancies as of June 30, 2001. Their efforts were beneficial as they provided a better understanding of the differences in the various data used by the entities. However, the efforts resulted in an estimate of vacancies that proved to be inaccurate.

To ensure that the State's decision makers have an accurate picture of the number of vacancies during the fiscal year, we recommended that Finance and the SCO, in consultation with the Legislature, work together on a method to calculate an up-to-date and reliable number of vacant positions statewide.

➲ ***Finance Action: None.***

Finance stated that, because of the state hiring freeze and the reductions of positions over the next several months, it would not be possible for it and the SCO to develop a method to provide up-to-date and reliable calculations of vacant positions.

STATE CONTROLLER'S OFFICE

Does Not Always Ensure the Safekeeping, Prompt Distribution, and Collection of Unclaimed Property

Audit Highlights . . .

Our review of the State Controller's Office (controller), Bureau of Unclaimed Property (bureau), revealed the following:

- ☑ *The bureau's computerized Unclaimed Property System lacks sufficient controls to prevent unauthorized changes, and the duplication of account data, potentially resulting in the payment of fraudulent or duplicate claims.*
- ☑ *The bureau's manual tracking of securities is unreliable and the bureau is inconsistent in how quickly it sells securities.*
- ☑ *The bureau excludes more than $7.1 million in unclaimed property from its Web site.*
- ☑ *The bureau does not consistently review and distribute claims in a reasonable amount of time.*
- ☑ *The bureau does not ensure that it receives all of the reported contents of safe deposit boxes.*
- ☑ *The controller's Financial-related Audits Bureau did not pursue an estimated $6.7 million in unclaimed property from one holder.*

REPORT NUMBER 2002-122, JUNE 2003

State Controller's Office response as of December 2003

The Joint Legislative Audit Committee (audit committee) requested that we evaluate the process used by the State Controller's Office (controller) Bureau of Unclaimed Property (bureau) for identifying unclaimed property from corporations, business associations, financial institutions, insurance companies, and other holders. Further, the audit committee asked us to determine whether the bureau distributes unclaimed property to eligible recipients accurately and in a timely manner. We were also asked to evaluate the bureau's process of safeguarding unclaimed property in its custody. Lastly, we were to determine whether the bureau evaluates claimant satisfaction, is responsive to complaints, and has a process in place to identify and implement corrective action.

Finding #1: Inaccurate data contained in the bureau's property system has resulted in the payment of fraudulent and duplicate claims.

The bureau relies on its computerized Unclaimed Property System (property system) to track unclaimed property escheated to the State by persons and businesses holding unclaimed property (holders) and to disclose that the controller has the unclaimed property. However, the property system is not sufficiently reliable. Our primary concern is that the controller has not implemented controls to prevent bureau employees from making unauthorized changes to the system, despite knowing about this problem for eight months. Further, the property system does not generate reports that would reveal when unauthorized changes are made and by whom. These flaws allowed two student assistants to conspire to modify owner names in the data and allowed their accomplices to fraudulently claim some of the property.

Prior to 2002, the property system lacked effective controls to prevent duplicate data from being loaded into the property system. Although the controller took action to correct this weakness, as of May 6, 2003, the bureau had not yet removed all of the duplicate data from its property system. While the Information Systems Division reports it has taken action to prevent payments on properties listed on the duplicate reports, some of the properties are still on the bureau's Web site. Individuals using the Web site to determine whether the controller has their property may inadvertently conclude that they are owed more than the actual amount.

The bureau does not reconcile the total amount remitted for each holder report to the total of all the individual accounts loaded into the property system by that report. This may result in claimants not receiving funds to which they are legally entitled. In addition, the bureau's staff manually entered nearly 6,700 holder reports directly into the property system due to problems with a holder's electronically submitted reports. In doing so, the bureau bypassed most of the automatic system checks that could have identified errors in the data, such as checking for duplicate information. The bureau has established a procedure to verify the data in these records as claims come in, but it does not intend to verify all of the data entered directly into the property system.

To increase the reliability of the data in the property system, the bureau should do the following:

- Implement the programming changes necessary to ensure that employees cannot make unauthorized and unmonitored changes to the property system.

- Remove all duplicate account data from the property system.

- Ensure that both current and newly hired staff review unclaimed property accounts entered manually when claims are filed against the property to determine the accuracy of the data.

To ensure the accuracy of the data loaded into the property system, the bureau should require its staff to reconcile the total amount remitted by each holder to the total of all the individual records in the property system for that report.

Controller's Action: Corrective action taken.

The controller modified its property system to limit on-line property updates and to generate audit reports that allow supervisory review of any such on-line transactions. Additionally, the controller developed a plan to delete all the duplicate reports from the system, including modifying the property system to prevent the duplicate properties from appearing on the bureau's Web site.

Furthermore, the controller conducted training classes to ensure that all staff continues to adhere to current procedures for verification of claims filed for properties on the reports entered manually. The controller retrained staff on proper procedures for holder overpayments. Additionally, the controller made the necessary programming changes to fix system problems, including the development of a periodic report to identify any out of balance reports.

Finding #2: The bureau may incorrectly bill holders for interest penalties.

Inaccuracies in the property system may result in the incorrect billing of holders for interest penalties from which they should be exempt under the controller's amnesty program. Beginning in 2000, holders were allowed amnesty for their past failures to report unclaimed property on or before November 1, 1999, and were exempted from paying an interest penalty. However, the bureau did not include an amnesty indicator in the property system for all qualifying holder reports, and the controller has not modified its program that calculates interest penalties to exclude holder reports that were granted amnesty. The controller will have to correct both problems to avoid inappropriately billing the holders that it granted amnesty.

To prevent the billing of penalties for late reporting to holders granted amnesty, the controller should do the following:

- Identify reports covered by the amnesty program that do not currently have an amnesty indicator and add it.

- Modify its program that generates bills for interest penalties to exclude those reports with an amnesty indicator.

Controller's Action: Corrective action taken.

The controller reconciled all amnesty reports in the tracking system and the unclaimed property system. Further, the controller reviewed interest billings previously issued to verify that no erroneous billings were issued for approved amnesty reports. Additionally, the controller modified its procedures to ensure that all interest billings are reviewed and that no amnesty reports are incorrectly billed for interest. Lastly, the controller developed a plan for programming changes to prevent generating interest billings for approved amnesty reports.

Finding #3: Although holder reports must be processed in order to account for property escheated to the State, thousands of holder reports await processing.

To allow for the tracking and eventual disbursement of unclaimed property, the bureau must process the holder reports by loading the detailed owner data into the property system. Although the bureau must complete this process to be able to disclose on its Web site that it has the owner's property, to pay claims, to bill holders for interest due on late filings, and to reconcile the amounts reported by the holders to the amounts actually remitted by the holders, it told us that, as of June 5, 2003, it had not uploaded more than 8,500 holder reports, some as far back as 1996. More than 4,500 of these reports are less than one year old and are not considered a backlog.

During discussions with the bureau, we learned that two conditions contributed to its backlog of holder reports:

- Electronic reports in unreadable formats.
- Large increases in the number of holder reports submitted.

To enable the bureau to upload data reported in formats that it cannot access, it should do the following:

- Continue its efforts to contact the holders and request that they resubmit the owner data in the current reporting format.
- Consider contracting with an outside entity to read the remaining reports or to convert them into a usable format.

To allow for the timely notification to owners that the State has their property and the prompt billing of interest penalties, the bureau should ensure that it uploads holder reports within 12 months of receipt.

Controller's Action: Corrective action taken.

The controller completed its analysis of the backlogged reports and contacted the holders as necessary for any replacement media needed. Further, the controller developed alternatives for reading or converting any remaining reports, including options to contract with an outside firm, if necessary, to read or convert the data. Lastly, the controller developed a plan to process reports within a year of receipt.

Finding #4: The bureau's tracking of securities in its custody needs improvement.

Because the bureau cannot use the computerized property system to track changes in securities, it tracks these manually, increasing the probability of error and the number of staff needed to accommodate the workload. We found that the bureau's manual tracking of securities is unreliable and that the bureau is inconsistent in how quickly it sells securities. Moreover, because the bureau tracks securities by company name rather than by individual owner, when corporate actions such as stock splits result in the issuance of additional securities, the bureau does not consistently associate the new securities with the original securities. This results in securities for the same owner being sold on different dates for different prices, further complicating the bureau's reconciliation process, increasing both the potential for errors and the risk of allegations that the bureau has mismanaged owners' assets.

To eliminate the bureau's manual tracking of securities and dispel any impressions that it exercises judgment in deciding when is the best time to sell securities, thereby reducing the potential for errors, eliminating unnecessary work, and reducing the potential for litigation against the State, the controller should seek legislation to require it to sell securities immediately upon receipt. To ensure that the holders remit all of the reported securities, the bureau should compare the shares received to the shares reported by the holders, using the holder report summary sheets.

Alternatively, the controller should consider having holders deliver duplicates of the securities they have transferred into the controller's name to a specified broker authorized to accept them on the State's behalf. The controller should instruct and give the broker authorization to sell the securities immediately upon receipt. This may also require legislation. Additionally, the bureau should immediately sell all securities already in its custody.

If the bureau is unable to sell securities immediately upon receipt, it should do the following:

- Reconcile the securities remitted to the securities reported within one month of the receipt of the securities, for securities not already in its custody.

- Modify the property system to allow it to track all changes to securities, including the effective dates, receipts, sales, disbursements, and corporate actions, on an owner-by-owner basis. The bureau should ensure that it updates the property system to account for securities currently tracked in its manual ledgers. This process should be automated to allocate changes in the number of securities to the affected accounts with minimal human intervention.

- Sell all securities related to a particular account within two years of the initial receipt, regardless of corporate actions. Additionally, the property system should be modified to generate a monthly report to alert the bureau to securities approaching the two-year deadline for sale, regardless of the timing of corporate actions.

In either case, the bureau should do the following:

- Review all of its manual ledgers to ensure that it has accurately recorded all corporate actions, receipts, sales, and disbursements of securities. Once this review is complete, the bureau should discontinue the use of its manual ledgers.

- Complete its reconciliation of the securities remitted to the securities reported for all securities not previously reconciled.

Legislative Action: None.

Although the controller did not seek legislation to require it to sell securities immediately upon receipt, as discussed in the following paragraph it did address the issue internally.

Controller's Action: Corrective action taken.

The controller directed staff to immediately sell securities received with holder reports. Further, the controller developed a plan to accelerate the sale of securities currently in house. Additionally, the controller reviewed options to streamline the process of escheating securities to facilitate the more immediate sale of securities. Future contracts with third-party contractors include a requirement that securities be delivered to the controller-contracted broker for immediate sale. The controller created standardized procedures for making entries into the security ledgers to improve consistency of entries in the ledgers, including a quality review of the entries. Additionally, the controller developed a plan to improve the timeliness of reconciling the remitted securities to reported securities.

Finding #5: Property belonging to governmental agencies and some private entities are excluded from the bureau's Web site.

We also found that the bureau excludes a large amount of unclaimed property reported to it for federal and state departments, local governments, schools and school districts, other states, and some private entities from its Web site. As of April 30, 2003, the bureau held more than $7.1 million in unclaimed property for various entities that it has not posted on its Web site. Even if the entities check the Web site to see if the State has some of their property, they would erroneously conclude that it does not.

To fully inform all entities that it has their unclaimed property in its possession, the bureau should do the following:

- Discontinue excluding any properties from its Web site.
- When it receives unclaimed property belonging to any governmental entity, notify that entity. If it does not receive sufficient information to determine which governmental entity the property belongs to, it should seek additional information from the holder.

Controller's Action: Corrective action taken.

The controller issued instructions to holders in writing and through the Web site of their responsibilities to notify owners prior to the escheatment of accounts. Additionally,

the controller discontinued its practice of excluding government properties from its Web site. Further, the controller developed a plan to notify government agencies of potential unclaimed properties in excess of $1,000 on an annual basis and simplified the process for transferring property to them.

Finding #6: The bureau does not approve and distribute claims in a timely manner.

The Unclaimed Property Law (law) requires the bureau to consider each claim for the return of property within 90 days after it is filed and to provide written notice to the person claiming the property (claimant) if the claim is denied. Although the law does not specifically require the bureau to approve or deny claims within 90 days, we believe that once the claimant has provided all required documentation, 90 days is a reasonable amount of time for the bureau to either approve or deny the claim. However, the bureau does not consistently do so. Claims for securities generally take longer to review and to distribute to the claimant than claims for most other types of property. Lastly, although the bureau has received numerous complaints regarding the timely distribution of claims, it has not streamlined the claim distribution process.

To ensure that it distributes assets to bona fide claimants in a timely manner, the bureau should do the following:

- Review all claims and either approve or deny them within 90 days of receipt.
- Distribute assets on approved claims within 30 days of approval.

Controller's Action: Corrective action taken.

The controller identified means of streamlining the approval of claims by increasing the threshold for applying its streamlined claim approval process from $1,000 to $5,000. Additionally, the controller created a new unit to process unclaimed property claims from heirfinders and investigators.

Finding #7: The bureau does not compare the contents of safe deposit boxes it receives to the holder-prepared inventories.

To determine the adequacy of the bureau's safekeeping of the contents of safe deposit boxes, we reviewed a sample of 32 safe deposit boxes. We expected that the bureau's inventories would conform materially to the holders' inventories; however, we found that the bureau does not reconcile the holders' inventories to its own inventories or to the boxes' contents to ensure that it has received all of the property listed. Instead, the bureau creates its own inventories from the contents actually received and usually disregards the holder inventories. The bureau's process of creating its own inventories results in unnecessary work and does not ensure that it has received all of the reported contents of the safe deposit boxes. If the bureau compared the contents received to the contents reported by the holder, it would be able to identify any missing property and take prompt action to request that the holder either explain the difference or remit the missing property. Doing so would reduce its liability for items that were not remitted by the holder.

To ensure that it has properly accounted for all of the owners' properties, the bureau should develop a standard inventory form for holders to use to report the contents of safe deposit boxes and for the bureau to use to verify that it has received all of the reported contents from the holders. This standard form should include a section for the bureau to indicate its receipt of all of the reported contents, the date of review, and any follow-up required for contents that were reported but not remitted by the holder.

Controller's Action: Pending.

The controller will develop and implement the necessary forms, instructions, and procedures.

Finding #8: Although state law allows the bureau to auction the contents of safe deposit boxes, it did not auction property for almost two years.

The law allows the bureau to sell the contents of safe deposit boxes in its custody to the highest bidder at public sale, including sales via the Internet. Although the bureau is not required to sell the contents of safe deposit boxes, failure to do so results in higher costs to the State to store and safeguard those contents. The floor of the bureau's vault is crowded with the safe deposit box contents it has received from holders but has not sent to

storage, and its shelves are overflowing with binders and the bagged contents of safe deposit boxes. We found that the bureau had not conducted an auction for almost two years, resulting in the overcrowding of its safe deposit box vault with the contents of safe deposit boxes that it has received from holders.

To reduce the overcrowding in its safe deposit box vault, the bureau should conduct an auction of the contents of safe deposit boxes at least monthly.

Controller's Action: Partial corrective action taken.

The controller completed a pilot project for conducting on-line Internet auctions of safe deposit box contents. Further, the controller implemented an ongoing on-line auction using new procedures and system updates to verify that sale proceeds are received for all items sold. The controller explored the need for additional space for secured storage of the safe deposit contents to reduce the overcrowding.

The controller completed its Request for Proposal with a private auctioneer to conduct a large public auction of unclaimed property. Additionally, the controller created new procedures to verify and reconcile public auction proceeds to the actual hammer price from the auction. The controller developed a plan to implement programming changes to post auction proceeds to the related owner's account.

Finding #9: The controller does not ensure the collection of all unclaimed property.

The controller's Financial-related Audits Bureau (audit bureau) does not always fully pursue unclaimed property that its auditors have a reasonable basis for believing should be remitted to the State. Specifically, we found that even though its auditors estimated in January 2002 that one holder failed to remit $6.7 million beginning as far back as 1978, the audit bureau did not move forward to substantiate or invalidate the estimated findings. After we brought this to the controller's attention, the audit bureau reopened the examination of the holder. Assuming that the audit bureau substantiates the $6.7 million and the holder remits the funds on June 30, 2003, the estimated interest penalty would be nearly $8.2 million, resulting in the potential collection of more than $14.9 million. By not exercising due diligence in pursuing the collection of unclaimed property that there is a reasonable basis to believe should have been remitted,

the controller is not fulfilling its responsibility to reunite owners with their lost or forgotten property.

To ensure that it collects all unclaimed property, the controller should complete its examination of estimated unclaimed property that its auditors have a reasonable basis for believing should be remitted to the State. Further, the bureau should ensure that it bills and collects the applicable interest penalties based upon the results of the audit bureau's examination.

Controller's Action: Pending.

The controller plans to complete its follow-up examination to substantiate or invalidate the estimated unclaimed property referred to in the examination of this holder by January 31, 2004. Further, the controller plans to bill the holder for any additional audit findings by February 27, 2004.

STATE OF CALIFORNIA

Its Containment of Drug Costs and Management of Medications for Adult Inmates Continue to Require Significant Improvements

Audit Highlights . . .

Our review of the State's drug and medical supply procurement practices reveals:

- ☑ *Annual expenditures for the five agencies most frequently purchasing drugs increased by an average of 34 percent per year between fiscal years 1996–97 and 2000–01.*
- ☑ *The Department of General Services has explored a variety of options, but it has not gone far enough in improving the State's drug procurement process. Moreover, the State needs a statewide process for contracting for medical supplies.*
- ☑ *The Department of Corrections' (Corrections) Health Care Services Division continues to have significant weaknesses that prevent it from effectively monitoring its pharmacies' purchases of drugs, such as:*
  - *As of November 2001 it had not updated its formulary nor monitored compliance with the existing one.*
  - *It lacks a utilization management program that can assist in reducing costs.*

REPORT NUMBER 2001-012, JANUARY 2002

Department of General Services' response as of January 2003 and Department of Corrections' response as of December 2002

Chapter 127, Statutes of 2000, required the Bureau of State Audits (bureau) to report to the Legislature on the trends in state costs for the procurement of drugs and medical supplies for offenders in state custody and to assess the major factors affecting those trends. The statutes also required the bureau to summarize the steps that the Department of Corrections (Corrections), the Department of General Services (General Services), and other appropriate state agencies have taken to improve drug and medical supply procurement and to comply with prior bureau recommendations relating to necessary reforms to improve the procurement of drugs.

In fiscal year 1996–97 state agencies purchased $41.6 million in drugs, but in fiscal year 2000–01 their purchases rose to $135.1 million, which represents an annual average increase of 34.3 percent for this five-year period. During the same period state agencies' expenditures for medical supplies rose from $11.1 million to $14.2 million, which represents roughly a 27 percent increase.

Restrictions in state and federal law prevent human immunodeficiency virus-positive inmates in federal and state prisons, such as Corrections', from benefiting from the State's AIDS Drug Assistance Program. Further, Corrections may not use the federal supply schedule, which by federal law places limits on the prices of drugs that the federal Department of Veterans Affairs, the Department of Defense, the Public Health Service, and the Coast Guard purchase because it is not affiliated with one of these eligible federal agencies.

However, we found that General Services and other state agencies such as Corrections could do more to control the State's drug and medical supply expenditures. Specifically, we found:

- Its pharmacy staff do not regularly review monthly reports to understand if purchases are cost-effective.

- Its pharmacy prescription tracking system cannot support monitoring, cost-containment efforts, or day-to-day management of pharmacy services.

- Corrections does not plan to replace this system until November 2006, and development of the new system is already behind schedule.

- Finally, we found that Corrections is not eligible for some options, such as the AIDS Drug Assistance Program and the federal supply schedule.

Finding #1: General Services needs to do more to identify the best option for reducing drug costs.

General Services has not been successful in securing more individual contracts with drug manufacturers for more drugs at less-than-wholesale acquisition cost, the standard price a wholesaler pays a manufacturer for drug products not including special deals, such as rebates or discounts. Further, General Services recently contracted with the Massachusetts Alliance for State Pharmaceutical Buying but failed to fully analyze other options, such as contracting with Minnesota Multistate Contracting Alliance for Pharmacy (MMCAP) or directly with a group-purchasing organization, before doing so. This action may have prevented the State from achieving greater future savings.

General Services should increase efforts to solicit bids from drug manufacturers so that it can obtain more drug prices on contract. Further, General Services should fully analyze measures to improve its procurement process, such as joining MMCAP or contracting directly with a group-purchasing organization.

General Services' Action: Partial corrective action taken.

General Services reported that it has awarded two-year contracts covering 321 line items, primarily generic drugs, which went into effect on November 1, 2002. Further, based on analysis of the bids it received, General Services identified an additional 140 drug line items for inclusion in its contract with the Massachusetts Alliance for State Pharmaceutical Buying (Massachusetts Alliance). In January 2003 General Services received statutory authority to enter into contracts

in a bid or negotiated basis with manufacturers and suppliers of single-source or multi-source drugs, which it believes allows it to explore additional strategies for managing drug costs.

General Services also reported that it was conducting a detailed review of the effectiveness of using the Massachusetts Alliance. General Services stated that as part of its review it surveyed a number of group-purchasing organizations and compared the advantages of using other group-purchasing organizations with its current relationship with the Massachusetts Alliance. General Services told us that its current agreement produced the greatest savings, which it estimated at roughly $5.9 million annually. General Services stated that it is committed to continually evaluating other approaches and is working with MMCAP to analyze drug procurement data.

Finding #2: Although General Services is spearheading efforts to develop a statewide drug formulary, it has not ensured that state agencies will be able to enforce the formulary.

A drug formulary is a listing of drugs and other information representing the clinical judgment of physicians, pharmacists, and other experts in the diagnosis and treatment of specific conditions. One of the main purposes of a formulary is to create competition among manufacturers of similar drugs when the clinical uses are roughly equal. The success of a statewide formulary and the State's ability to create enough competition to negotiate lower drug prices for certain products depend on how well state agencies adhere to the statewide formulary when they prescribe drugs. Currently, Corrections, which was responsible for roughly 68 percent of the State's drug purchases in fiscal year 2000–01, has an outdated formulary and lacks sufficient data to perform reviews that can identify prescribing patterns. Agencies that help develop but do not adhere to strict guidelines for enforcing the formulary would negate the State's effort.

Therefore, General Services should fully consider, and attempt to mitigate, all obstacles that could prevent the successful development of a statewide formulary.

General Services' Action: Partial corrective action taken.

General Services has formed a Pharmacy Advisory Board (board) to assist in its implementation and administration of a statewide pharmaceutical and medical supply program. The board held one meeting in September 2002 and plans to hold its next meeting in early 2003. General Services' Common Drug Formulary Committee, which is a subcommittee of the board, has received approval to begin contract negotiations for a number of proprietary drugs that were recommended for inclusion on the State's common drug formulary listing.

Finding #3: The State lacks statewide agreements for purchasing medical supplies.

Often state agencies are not aware of what their institutions are purchasing and how much they are paying for medical supplies. Typically, each state agency or individual institution generally procures its own medical supplies. Currently, General Services has only two medical supply contracts and is unaware of what medical supplies the agencies use and what they pay for them. However, it believes that having a medical supply catalog would aid state agencies in obtaining these supplies.

General Services should ask state agencies to determine their needs and then consider contracting for a medical supply catalog to maximize the State's buying power.

General Services' Action: Partial corrective action taken.

General Services has formed a Medical and Surgical Supply subcommittee to focus on the needs of state and local government entities. General Services reported that it is developing a request for proposal for the medical and surgical supply program, which it expects to release in early 2003.

Finding #4: Corrections' Health Care Services Division (Health Care Services) lacks an effective system for controlling drug purchases.

Despite the recommendation in our January 2000 report to update its departmental formulary and use it to control which drugs medical professionals can prescribe routinely, as of November 2001, Corrections' Health Care Services still had not done so. Further, Health Care Services does not monitor its pharmacies' noncontract purchases from the

State's prime vendor and cannot substantiate the reasons they are choosing to purchase potentially more expensive noncontract drugs. Until Health Care Services addresses significant deficiencies, neither an external or internal pharmacy benefits manager can accomplish the task of improving its contracting and procurement for drugs.

As we previously recommended, Health Care Services should update its formulary and ensure that headquarters and prison staff monitor compliance with the formulary. Further, Corrections should ensure that prisons receive monthly contract compliance reports from the prime vendor and use them to monitor noncontract purchases. Finally, Corrections should await the results of its consultant's report and identify those recommendations that will be beneficial to the program. Only then should it decide whether to hire an internal or external pharmacy manager to assist in resolving its pharmacy operations deficiencies.

Corrections' Action: Partial corrective action taken.

Corrections reported that it had revised its formulary and planned to distribute it in early 2003. It also plans to hold trainings on this formulary and on the use of reports it receives from the prime vendor to monitor noncontract purchases. Corrections also reported that it received its consultant's report and identified the recommendations beneficial to the pharmacy program, such as the creation of a Pharmacy Services Unit at its headquarters. However, although it has identified the resources necessary to implement the recommendations, Corrections reported that it is still in the process of filling the position of pharmacy services manager for that unit.

Finding #5: Health Care Services did not always meet criteria for using mail-order pharmacy services.

Although Corrections obtained approval from General Services to use mail-order pharmacy services in prisons when pharmacist vacancy rates rise to more than 50 percent, it did not demonstrate that the use of mail-order pharmacy services was necessary. Specifically, we cannot substantiate Corrections' shortage of pharmacists and thus its need for mail-order pharmacy services because Health Care Services lacks sufficient information about its use of registry employees. A registry service provides

pharmacists who can fill in for long- or short-term staffing needs resulting from vacancies, illnesses, or exceptional workload conditions.

Further, Corrections still has not addressed our previous recommendation that it consider whether it has appropriately divided responsibilities between its pharmacists and pharmacy technicians. This analysis could indicate that Corrections may be able to allow pharmacy technicians to assume more responsibilities so that it can lower the number of pharmacists necessary to run its pharmacies.

Corrections should take the necessary steps to substantiate its position that a shortage of pharmacists exists. Additionally, it should analyze whether it has the appropriate division of responsibilities between its pharmacists and pharmacy technicians. If it is able to substantiate that a pharmacy shortage exists and General Services approves another contract for mail-order pharmacy services, Health Care Services should ensure that prisons meet the contract conditions before beginning to use these services and monthly thereafter.

Corrections' Action: Partial corrective action taken.

Corrections reported that it has gathered and reviewed data related to pharmacists, pharmacy technicians, the number of satellite pharmacies, and its use of registry pharmacists to evaluate the extent of a pharmacist shortage. However, Corrections told us that it is unable to determine the appropriateness of the staffing ratios until it decides on which consultant recommendations it will implement.

Finding #6: Although its prescription tracking system is inadequate, Corrections has made little progress in implementing a new system.

Corrections has been trying to replace its prescription tracking system and other health care information technology systems since 1991 without significant progress. Currently, it is behind schedule on its plans to implement a new health care management system by November 2006 as part of its Strategic Offender Management System and is not considering an automated pharmacy system in the interim.

Corrections should accelerate the acquisition and implementation of the Strategic Offender Management System and its new health care management component.

Corrections' Action: Partial corrective action taken.

Corrections reported that its implementation of the new system depends on infrastructure and resources. However, Corrections also reported that it has completed a feasibility study report, as an interim solution, to procure an existing pharmacy management software package for its local institutions and headquarters. Corrections told us that the report is being reviewed by the Department of Finance.

Finding #7: Corrections made significant errors in attempting to streamline its drug dispensing process.

Corrections neither sought the necessary approvals to contract with the vendor of an automated drug delivery system nor ensured that it uses the system in accordance with state law. The California State Prison, Sacramento's, entering a limited-time agreement to obtain two machines for $4,999.99 appears to be a circumvention of the State's requirement of securing at least three competitive bids for each contract of $5,000 or more.

Corrections also failed to consider thoroughly the legal ramifications of using an automated drug delivery system. To control misuse, state law allows the removal of drugs from these machines in only one of three circumstances: (1) to provide drugs for a new prescription order, (2) to provide drugs in an emergency, or (3) to provide drugs that the medical practitioner has prescribed for an inmate to take as the need arises. Corrections contends that it is using the system appropriately, since the law pertains only to skilled nursing or intermediate care facilities. However, our attorney's analysis of the law is that Corrections' authority to use these machines in health care facilities in its prisons is unclear. Specifically, although the legislative history of Senate Bill 1606 indicates that the Legislature had skilled nursing and intermediate care facilities in mind when drafting it, the state law setting forth the circumstances in which automated drug delivery machines may be used refers to "facilities" in a generic sense and not merely skilled nursing and intermediate care facilities.

Corrections should cease using its automated drug delivery system until it secures a contract in accordance with the State's public contracting laws. Further, Corrections should seek an opinion from the attorney general to support its current use of the machines.

Corrections' Action: Partial corrective action taken.

Corrections reported that it received approval on a contract for the automated drug delivery machines on December 24, 2001. However, Corrections has chosen not to seek an opinion from the attorney general because it does not believe that Health and Safety Code, sections 1261.5 and 1261.6, apply to its pharmacies.

CALIFORNIA DEPARTMENT OF CORRECTIONS

A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management's Control

REPORT NUMBER 2002-101, JULY 2002

California Department of Corrections' response as of August 2003

Audit Highlights . . .

Our review of the California Department of Corrections' (department) ongoing fiscal problems revealed:

- ☑ *A shortage of correctional officers continues to drive overtime costs higher.*
- ☑ *At its current pace of hiring, it may take the department until 2009 to meet its need for additional correctional officers.*
- ☑ *Some officers work excessive amounts of overtime while others at the same prison work very little overtime.*
- ☑ *Certain provisions in the labor agreement between the State and the California Correctional Peace Officers Association, related primarily to correctional officers, will eventually add about $518 million to the department's annual costs.*

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of various Department of Corrections' (department) fiscal problems. The audit committee expressed particular interest in the collective bargaining process that governs the department's relationship with its correctional officers, the assignment of new cadets from the academy to prisons, the impact of statewide mandated salary savings on correctional officers' use of overtime and sick leave, and the impact of medical transportation costs on the cost of medical care.

Finding #1: The department pays large overtime costs to cover for unmet correctional officer need.

The department has been unable to attract and train enough correctional officers to meet its needs. Specifically, as of September 2001, its full-time and intermittent officers numbered only 19,910 while its budget and labor agreement allow for a maximum of 23,160 officers. As a result, the department has an unmet need of about 3,250 officers. To fill this unmet need, the department has resorted to assigning overtime. During the first half of fiscal year 2001–02, the department spent more than $110 million on custody staff overtime—already $36 million more than its overtime budget of $74 million for the entire fiscal year. We estimate that the department will not fill its unmet officer need until sometime between the end of 2005 and the beginning of 2009, depending on the number of future academy graduates and the officer attrition rate.

To reduce its use of overtime, the department should consider the feasibility of further increasing the number of correctional officer applicants and, if warranted, the physical capacity for training them. Additionally, the department should pursue additional funding from the Legislature to operate its academy at full capacity. Once it can attract more cadets to its academy, the department should pursue funding for additional correctional officer positions that it will need to reduce its reliance on overtime. Until such time, as the department has enough correctional officers to meet its needs and incurs only unavoidable overtime, the department should be realistic in its budget and plan for the overtime it will need to cover its unmet need. Finally, the department should maximize its use of intermittent officers by either converting them to full-time or ensuring that they work as close to the 2,000-hour-a-year maximum as possible.

Department Action: Partial corrective action taken.

The department states that as part of the fiscal year 2003–04 governor's 20 percent reduction plan, it submitted a proposal to restructure the academy so that 12 weeks of training will be provided at the academy and the remaining four weeks of training will be provided at the cadets' assigned institution. The department asserts that the authority for this change was contained in Senate Bill 19X and was signed into law by the governor in March 2003. However, implementation of the restructured academy is contingent upon the State and the union representing correctional officers reaching agreement on the implementation of the on-the-job training requirement. The department indicates that it is in negotiations with the union regarding this issue. The department believes that the reduced length of the academy will allow it to schedule an additional two classes per year, potentially graduating several hundred additional officers per year.

The department also states that it is pursuing authority and funding for additional correctional officer positions, and indicated that the use of sick leave by correctional officers continues to be a major contributor to overtime. In addition, the department stated that as part of its analysis of correctional officer needs through June 2005, it has developed procedures to project the overtime necessary to cover vacancies, and has incorporated this information into its fiscal year 2003–04 budget request. Further, the department indicated that its institutions maximize their use of intermittent officers by converting them to full-time when positions become vacant and if, or when, intermittent officers are eligible for and accept

permanent positions. Finally, the department reports that 193 intermittent officers were appointed to full-time positions during the period from January 1, 2003, to June 30, 2003.

Finding #2: Savings from vacant budgeted positions are insufficient to finance shortfalls in the overall funding for correctional officers and overtime.

The savings the department realizes by intentionally leaving more than 1,000 of its authorized correctional officer positions vacant under the Institutional Vacancy Plan do not result in net salary savings because the budget for each officer is not sufficient to meet the actual costs when an officer works full time. Specifically, we estimated that the department would experience a net deficit of about $193 million related to its funding of correctional officers and overtime in fiscal year 2001–02.

To reduce its use of overtime, the department should fill vacant relief officer positions currently in its Institutional Vacancy Plan once it has filled its positions currently vacant because of insufficient staff.

Department Action: Partial corrective action taken.

The department states it is making every effort to fill vacant positions. The department reports that it has reduced its vacant permanent full-time positions to 429 as of June 30, 2003, compared to 1,040 at June 30, 2002. It also indicates that 160 additional cadets were scheduled to graduate in August 2003, and another 504 in October 2003. Finally, the department notes that it continues to work with the administration related to its long-term staffing needs, including developing a strategy related to the remaining vacant relief officer positions in its Institutional Vacancy Plan.

Finding #3: A more strategic assignment of new cadets and better monitoring of overtime worked at each prison would be beneficial.

The department does not consider the varying amounts of overtime that correctional officers work at its prisons when assigning cadets from its academy. In particular, based on our review of the November 2001 academy, we found that there was no strong correlation between the assignments of new cadets and the amount of overtime at each prison. In addition, we found that a total of 235 officers at 26 different prisons averaged more

than 80 hours of overtime each work period between July and December 2001. The department could also better protect the health and safety of everyone in the prison setting by more evenly distributing the total overtime among individual officers within each prison.

To reduce health and safety risks for its employees, the department should reassess the number of budgeted full-time positions at each prison and determine whether reallocations are warranted because of excessive overtime at specific prisons. Additionally, the department should pursue options to limit overtime that individuals work so that individuals do not exceed the 80-hour cap considered relevant for health and safety risks.

To better match the supply of correctional officers with the demand for correctional officers that use of overtime hours indicates, the department should consider assigning its academy graduates to those prisons that experience the highest levels of overtime. For example, if it has too many qualified candidates to fill a class, the department could give preference to candidates willing to go to the 10 prisons with the most overtime.

Department Action: Partial corrective action taken.

The department states that it is conducting a standardized staffing study that will assess staffing needs and establish standardized staffing patterns for each prison based on mission and location. In addition, the department reports that the number of correctional officers averaging more than 80 hours of overtime has decreased from the 235 we reported for July through December 2001, to 159 for January through June 2003. Further, the department states that until the pool of candidates on its correctional officer certification list increases significantly, competition is inadequate to make high vacancy institutions attractive to correctional officer candidates. Nevertheless, the department will continue efforts to increase the pool of candidates willing to work at high vacancy institutions.

Finding #4: Certain provisions of the new labor agreement increase the department's fiscal burden and limit management's control.

The new labor agreement between the State and the California Correctional Peace Officers Association includes many provisions that either increase personnel costs or create challenges for the department to effectively manage its staff. Ranging from salary

increases and enhanced retirement benefits to seniority-based overtime, some of these provisions were included in the prior labor agreement, but many are new to the labor agreement that was ratified in February 2002. The department estimates that the annual cost of new provisions in the agreement will be as high as $300 million a year by fiscal year 2005–06, the latest year for which it has estimated costs. In developing these estimates, the department included classes of employees who are covered by the agreement, such as medical technical assistants and correctional counselors, as well as correctional officers. Focusing mainly on costs related to correctional officers and including the entire term of the labor agreement, we analyzed five new and three continuing provisions of the labor agreement and estimate that the department's annual costs for these provisions will eventually amount to about $518 million. Further, several changes in the provisions related to sick leave have likely resulted in additional overtime to cover for the increased use of sick leave. Finally, a continuing provision related to how post assignments are made limits the department's ability to assign particular individuals to posts of its choosing.

SUPERIOR COURTS

The Courts Are Moving Toward a More Unified Administration; However, Diverse Service, Collection, and Accounting Systems Impede the Accurate Estimation and Equitable Distribution of Undesignated Fee Revenue

REPORT NUMBER 2001-117, FEBRUARY 2002

Administrative Office of the Court's response as of March 2003

Audit Highlights . . .

Our review of certain court-related fees and the fiscal and administrative oversight of superior court operations found that:

- ☑ *The Lockyer-Isenberg Trial Court Funding Act of 1997 addressed the disposition of some fees, but did not specify who would receive others, referred to as undesignated fees.*
- ☑ *Due to the decentralized nature of the superior courts' accounting and collection processes, it is prohibitively complex to determine the precise amount of revenue generated by undesignated fees.*
- ☑ *We estimated that the largest division in each of the three largest superior courts together generated $17.4 million in undesignated fee revenue during fiscal year 2000–01, most of which was distributed to the counties in accordance with locally negotiated agreements.*

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The Joint Legislative Audit Committee requested that the Bureau of State Audits review a sample of superior courts to determine how much revenue is generated by fees not designated by the Lockyer-Isenberg Trial Court Funding Act of 1997 (funding act), which entities collect these revenues, and how the courts distribute them.

Finding #1: The working group inappropriately categorized certain fees as undesignated.

Although the funding act addressed the disposition of many court-related fees, it did not specify who should receive others, referred to as undesignated fees. To address this issue, a working group, comprised of representatives from selected courts and counties, was formed to recommend to the Legislature how to distribute these fees. The working group identified many fees and placed them in one of four categories. The first three categories recommended a particular distribution; however, the fourth category represented all those fees for which a recommendation could not be made. Our review of these fees found that some were in fact designated.

To ensure that all undesignated fees are properly identified and distributed, we recommended that the Administrative Office of the Courts (AOC) review and correct the working group's list of these fees.

☑ *Several issues must be resolved before the State can implement a consistent and equitable distribution of undesignated fee revenue.*

☑ *The Administrative Office of the Courts has initiated a wide-reaching management system for superior court resources; however, such actions will not ease efforts to determine how much revenue undesignated fees generate.*

AOC Action: Corrective action taken.

According to the AOC, the working group's listing of undesignated fees has been reviewed and corrected.

Finding #2: The California Constitution mandates that the entity incurring the cost in providing a service must retain the fees.

The California Constitution imposes the restriction that any revenue generated by certain undesignated fees must be distributed to the entity that incurs the cost of providing the service. This restriction does not apply to all governmental charges, including fines or penalties; however, it does apply to fees. Before a statewide designation could be assigned for any given fee, all 58 counties would have to fund the delivery of services in the same way. Therefore, when the State considers imposing a statewide designation for a particular fee it must first consider whether it is a court or county that provides the service, which we found varies from one jurisdiction to another. Currently, the superior courts and counties have made stipulations in their local agreements for the distribution of undesignated fee revenue.

Once the working group's listing of undesignated fees has been reviewed and corrected, we recommended that the AOC:

- Direct each superior court to identify the entity in its jurisdiction that incurs the cost of providing the service related to each undesignated fee on the list.
- Direct the superior courts to ensure that, in their agreements with their respective counties, the courts distribute each of these fees to the entity incurring the cost.
- Seek legislation designating the distribution of charges other than fees, such as penalties and fines.

AOC Action: Partial corrective action taken.

According to the AOC, it has surveyed each superior court regarding who incurs the cost, provides the service, and retains each undesignated fee. The AOC also stated that it has proposed language concerning the appropriate distribution of undesignated fees to be included in the local agreement between each superior court and its respective

county when the agreement is renewed. The AOC also stated that it has proposed legislation to clarify the disposition of undesignated fees, fines, and penalties where currently no statutory reference provides for their distribution and use.

OFFICE OF CRIMINAL JUSTICE PLANNING

Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery

Audit Highlights . . .

The Office of Criminal Justice Planning (OCJP) has not fulfilled all of its responsibilities in administering state and federal grants, including the domestic violence program. Specifically, OCJP:

- ☑ *Has not adopted guidelines to determine the extent it weighs grant recipients past performance when awarding funds.*
- ☑ *Does not always provide grant applicants the necessary information or time to challenge its award decisions.*
- ☑ *Missed opportunities to seek guidance an advisory committee could provide regarding program administration.*
- ☑ *Has not consistently monitored grant recipients.*
- ☑ *Spent $2.1 million during the last three years on program evaluations of uneven quality, content and usefulness.*

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REPORT NUMBER 2002-107, OCTOBER 2002

Office of Criminal Justice Planning and Department of Health Services' responses as of November 2003

The Joint Legislative Audit Committee (audit committee) requested an audit of Office of Criminal Justice Planning's (OCJP) administration of its grant programs in general and of its and the Department of Health Services' (DHS) administration of their respective domestic violence programs in particular. The audit committee also asked us to identify alternatives to the current administrative structures for the domestic violence programs. We reported the following findings:

Finding #1: Weaknesses in OCJP's process for awarding grants may result in the appearance that its awards are arbitrary or unfair.

OCJP has not adopted guidelines weighing grant recipients' past performance when awarding funds, nor is its review process systematic enough to identify grant recipients with poor past performance. Moreover, OCJP does not always provide unsuccessful grant applicants the necessary information or time to challenge its award decisions, and it has missed opportunities to seek the guidance an advisory committee could provide regarding certain decisions that affect program administration.

To ensure its application process is perceived as fair and impartial, we recommended that OCJP take the following steps:

- Create guidelines and criteria to determine when an applicant's past performance issues rise to the level that OCJP will consider those issues when deciding whether or not to continue the applicant's funding.

Our review of the domestic violence programs administered by OCJP and the Department of Health Services (DHS) revealed that:

- ☑ *OCJP decided not to correct an inconsistency in its 2001 request for proposals, which resulted in fewer shelters receiving funding.*
- ☑ *DHS has not established guidelines as to how past performance will be considered when awarding grants.*
- ☑ *OCJP and DHS award the majority of their domestic violence funds to shelters for the provision of similar services.*
- ☑ *OCJP's and DHS's activities for awarding grants and providing oversight of recipients sometimes overlap.*

- Conduct a periodic uniform review of all applicants with regard to past performance issues that includes applying weighting factors that indicate the relative importance of each such issue as it relates to future funding.
- Promptly inform grant recipients when their past performances are jeopardizing their chances for future funding.
- Properly document the rationale not to fund grant recipients and clearly state in the rejection letters sent to the applicants the reasons that they were denied funding.
- Change the process for the filing of appeals so that an applicant has 10 to 14 calendar days, depending on the type of grant award, from the registered receipt of the notification letter in which to justify and file an appeal.

To improve outreach to its grant recipients and comply with legislation that is soon to take effect, we recommended that OCJP create an advisory committee for the domestic violence program that could provide guidance on key program decisions.

OCJP Action: Partial corrective action taken.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it had created a formal written policy to use when considering the past performance of an applicant as a factor in its funding decisions and that the new policy will be used for those applying for competitive funding under OCJP's next request for proposal. However, we reviewed the new policy and, while we believe it is a good first step, it is still too vague and subject to varying interpretation.

In order to address the possible view that the current appeals guidelines are overly strict in terms of the time allowed to file an appeal and that the denial notice is too limited concerning the reasons for the denial, OCJP has revised its appeals guidelines. The guidelines were reviewed and approved by an independent council that hears such appeals at the end of July 2003. The new guidelines, which were implemented August 1, 2003, permit more time to appeal and provide more information to those applicants that are denied.

Finally, OCJP stated it would work with the agency that will be administering the domestic violence program beginning in 2004—the Office of Emergency Services—to establish a Domestic Violence Advisory Committee that will provide insight and guidance in administering the domestic violence program.

Finding #2: OCJP does not provide consistent and prompt oversight of grant recipients.

Although OCJP conducts a variety of oversight activities, its efforts lack consistency and timeliness. It has not visited grant recipients as planned and has not considered prioritizing its visits to first monitor recipients with the highest risk of problems. It has also been inconsistent in following up on its grant recipients' submission of required reports, and it has not always reviewed required reports promptly and consistently. In addition, it has spent nearly $23,000 per year to review audit reports that another state agency also reviews. Finally, it has not always conducted sufficient follow-up on reports once it notified grant recipients of performance problems.

We recommended that OCJP take several actions to improve its oversight of grant recipients, including:

- Ensure prompt site visits of newly funded grant recipients.
- Establish a risk-based process for identifying the grant recipients it should visit first when it conducts monitoring visits.
- Develop written guidelines to determine when and how staff should follow up on late progress reports and ensure that existing guidelines are followed regarding the prompt follow up on late audit reports.
- Ensure that it reviews audit reports within six months of receipt in order to comply with federal guidelines and promptly follow up on audit findings until they are resolved.
- Revise its process for reviewing the audit reports for municipalities to eliminate duplicating the State Controller's Office's (SCO) efforts.
- Establish written guidelines to address how staff should follow up on problems identified in progress reports or during site visits to ensure they are resolved.

- Require that its monitors review grant recipients' corrective action plans to ensure problems identified during monitoring visits have been appropriately addressed through problem-specific narratives.

OCJP Action: Partial corrective action taken.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it has a goal of conducting one technical site visit for a new grant recipient within the first six months of the grant period and one monitoring visit within the three-year grant period. Therefore, at a minimum, every grant recipient should receive a visit at least once every three years. OCJP also stated it was continuing to implement its plan to prioritize monitoring visits based on identified problems, the length of time since the last visit, and the dollar value of the project. Once its grant programs are transferred to other agencies, OCJP stated it would work with the receiving agencies to ensure a smooth transition of the monitoring function.

OCJP stated that it has made significant progress in reducing its backlog of pending reviews of grantee audit reports. For example, OCJP reports it has reviewed 235 audit reports as of October 2003, and anticipates it will complete reviews of 269 more before it ceases operations at the end of the year, and will work with the agencies taking over its grant programs so that work continues on reducing the backlog. Finally, OCJP stated it intends to provide the written guidelines for its grant programs to those agencies slated to administer them once they are transitioned and will also help those agencies develop procedures for following up on problems identified in grantee progress reports, technical or monitoring site visits, or other sources such as audit reports.

Finding #3: OCJP has not properly planned its evaluations or managed its evaluation contracts.

During the last three years, OCJP's evaluation branch spent $2.1 million on activities that culminated in evaluations of uneven quality, content, and usefulness. The branch lacks a process that would help it determine what programs would profit most from evaluations, how detailed evaluations should be, what criteria evaluations must satisfy, and, until recently, how to ensure they contain workable recommendations. The branch has been lax in management of its contracts; as a result,

it did not include measurable deliverables in one contract and failed to ensure that it received the deliverables contained in others. It also circumvented competitive bidding rules in entering an agreement with a University of California extension school.

To improve its evaluations branch, we recommended that OCJP:

- Develop a planning process to determine what programs would profit most from evaluations, how rigorous evaluations should be, and that it follow its new process for discussing the relevance and feasibility of proposed recommendations to improve their chances for implementation.
- Develop general criteria establishing what evaluations should accomplish.
- Include measurable deliverables and timelines in its contracts with evaluators and hold evaluators to their contracts.
- Withhold payments to contractors whenever they do not provide established deliverables or when the deliverables are not of the quality expected.
- Ensure that interagency agreements with university campuses comply with state guidelines regarding competitive bidding.

OCJP Action: Partial corrective action taken.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that significant efforts have been make to identify and prioritize those evaluations that are mandated, and it is working to ensure that evaluation criteria and requirements are met. A new interim chief was assigned to oversee evaluation activities and has since issued five evaluation reports with plans to issue one more before OCJP ceases operations at the end of the year.

Finding #4: OCJP's allocation of indirect and personnel costs may have resulted in some programs paying for the administration of others.

OCJP's method for assigning indirect and personnel costs to the various programs it administers may result in some programs paying the administrative costs for others. Its allocation of indirect costs has been inconsistent, and it has not kept adequate records of

its allocation decisions to demonstrate that they were appropriate. OCJP has also failed to require its employees to record their activities when working on multiple programs as required by federal grant guidelines.

We recommended that OCJP ensure that it equitably allocates all indirect costs to the appropriate units and maintains sufficient documentation to support the basis for its cost allocation. OCJP also should establish an adequate time-reporting system that uses activity reports or certifications, as appropriate, to document the total activity for each employee and then use such reports or certifications as the basis for allocating personnel costs.

OCJP Action: Corrective action taken.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it had designed a functional timesheet modeled after those used by other state agencies, trained its staff on its use, and fully implemented the timekeeping system as of May 2003. The timesheets better ensure that costs are accurately recorded in the accounting system.

Finding #5: OCJP's decision not to correct an inconsistency in its request for proposals resulted in fewer domestic violence shelters receiving funding.

OCJP funded almost three fewer domestic violence shelters than it could have in fiscal year 2001–02 because it chose not to correct an inconsistency in the 2001 request for proposals for its domestic violence grant. This decision resulted in a reduction of nearly $450,000 a year of funds available for shelters. The error occurred during the development of its request for proposals, when program staff set the minimum amount that a small shelter would receive at $185,000 a year, even though an adjoining table within the proposal stated that $185,000 was the maximum amount that a small shelter could receive. The minimum amount was over $30,000 more for some small shelters than the minimum OCJP had previously awarded.

OCJP could provide no documentation of the decision-making process it used to arrive at the $185,000 funding minimum, such as written input from the shelters stating that the previous minimum amount was insufficient. Furthermore, OCJP provided

no indication that it had considered the consequences that raising the minimum funding amount of some shelters by as much as $30,000 would produce.

So that it can support and defend future funding decisions affecting the domestic violence program, we recommended that OCJP document and retain the reasons for changing funding levels.

OCJP Action: Pending.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that Senate Bill 1895 provided the authority to create an advisory council effective January 1, 2003, that could recommend specific future funding levels for all shelters in OCJP's domestic violence program. Further, OCJP stated it would work with the agency that will be administering the domestic violence program beginning in 2004—the Office of Emergency Services—to establish a Domestic Violence Advisory Committee that can provide such insight and guidance.

Finding #6: DHS has not considered past performance or been able to use its advisory committee when awarding grants.

DHS has not adopted guidelines or criteria to establish when a grant recipient's past performance has been sufficiently poor to prevent it from being awarded funds during the next grant cycle, nor has it established a systematic review process to identify grant recipients with poor past performance. Further, forces outside of its control precluded DHS from seeking counsel from a domestic violence advisory committee as required by state law.

We recommended that DHS develop guidelines and criteria to determine when a grantee's past performance warrants denying it funding in the next grant cycle, which would include performing a periodic uniform review of all grant recipients' past performance. Also, now that enough appointments have been made to the advisory council to create a quorum, DHS should meet frequently with the council to seek its input as required by law.

DHS Action: Partial corrective action taken.

DHS stated that it has begun to meet regularly with the domestic violence advisory council and will request that the council consider whether it should use the past performance of grant recipients in preparation for awarding funds in future Request for Applications (RFA). If past performance is to be used in determining grant awards, DHS will develop specific criteria.

Finding #7: DHS has not fully met its responsibility to oversee grant recipients.

DHS does not have a process to conduct state-mandated site visits of its grant recipients. Moreover, it has not considered prioritizing its visits to first monitor those with the highest risk of problems. It has also been inconsistent in following up on its grant recipients' late submission of required reports, and it has not always reviewed required reports promptly and consistently.

To ensure better oversight of its shelters, we recommended that DHS:

- More efficiently use its resources when complying with state law mandating technical site visits to all its shelters by establishing a risk-based process for identifying which shelters it should visit first.
- Develop a structured process for staff to use to follow up on late progress reports. This process should include documenting follow-up efforts.
- Ensure that staff follow existing guidelines regarding the prompt follow-up of late audit reports.
- Ensure that it reviews all submitted progress reports promptly.

DHS Action: Corrective action taken.

DHS stated that it has put a system in place to ensure that timely review and follow up of progress reports occurs and that the system includes a status log that lists all the deliverables required from the shelters, including progress reports. The status log contains a "notes" column to record staff follow-up efforts regarding late reports, and all written communication or e-mail contacts with the shelters will be maintained in the working file.

In addition, DHS stated that it had developed and maintains an audit-tracking log to monitor the receipt of audit reports, and has developed guidelines to ensure that audit reports are received on time. Finally, DHS stated that it is on schedule to complete at least one site visit to each shelter within the current grant cycle as required by law.

Finding #8: OCJP and DHS require separate grant applications for similar activities.

OCJP and DHS conduct separate grant application processes. As a result, shelters must submit separate applications describing how they will use each program's funds, although the applications and the services themselves are similar.

To reduce the administrative burden for the shelters, we recommended that OCJP and DHS coordinate the development of the application processes for their shelter-based programs and identify areas common to both where they could share information or agree to request the information in a similar format.

OCJP's and DHS's Actions: Pending.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services. DHS stated it would continue its efforts to coordinate the application process for the shelter-based program with this new administering agency.

Finding #9: OCJP and DHS perform some of the same oversight activities.

OCJP and DHS require shelters to submit periodic progress reports containing similar information, except that each requires the information for a different time period. Furthermore, as a result of a new legislative requirement, DHS will perform site visits to shelters to assess their activities and provide technical assistance, even though OCJP already conducts such visits.

To avoid duplicate oversight activities, we recommended that OCJP and DHS consider the following changes to their administrative activities and requirements:

- Align the reporting periods for their progress reports so that shelters do not have to recalculate and summarize the same data for different periods.

- Coordinate technical site visits, monitoring site visits, and audits that they schedule for the same shelters.

- Establish procedures for formally communicating on a regular basis with each other their ideas, concerns, or challenges regarding the shelters.

OCJP's and DHS's Actions: Pending.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services. DHS stated it would continue its efforts to coordinate the oversight process for the shelter-based program with this new administering agency to avoid duplication.

Finding #10: Greater cooperation or consolidation between OCJP's and DHS's programs could increase efficiency.

Because of the similarity of OCJP's and DHS's programs and the overlap between their application and oversight activities, adopting an alternative administrative structure could improve the efficiency of the State's approach to funding domestic violence services.

To improve the efficiency of the State's domestic violence programs and reduce overlap of OCJP's and DHS's administrative activities, we recommended OCJP and DHS, along with the Legislature, should consider implementing one of the following alternatives:

- Increase coordination between the departments.

- Develop a joint grant application for the two departments' shelter-based programs.

- Combine the two shelter-based programs at one department.

- Completely consolidate all OCJP's and DHS's domestic violence programs.

OCJP's and DHS's Actions: Pending.

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services. DHS stated it would continue its efforts to coordinate the process for administering the shelter-based program with this new agency to avoid duplication.

Legislative Action: Unknown.

We are not aware of any legislative action with regard to this recommendation.

GOVERNOR'S OFFICE OF EMERGENCY SERVICES

Investigations of Improper Activities by State Employees, March 2002 Through July 2002

ALLEGATION I2000-607 (REPORT I2002-2), NOVEMBER 2002

Governor's Office of Emergency Services' response as of September 2002[1]

Investigative Highlights . . .

The Governor's Office of Emergency Services engaged in the following improper governmental activities:

- ☑ *Allowed an employee (employee A) to continue to be paid for his commute time.*
- ☑ *Entered into an agreement with employee A's bargaining unit that the Department of Personnel Administration determined was invalid.*
- ☑ *Failed to follow its own administrative controls concerning overtime.*

In April 2000 we reported, among other things, that poor supervision and inadequate administrative controls in the fire and rescue branch of the Governor's Office of Emergency Services (OES) had enabled employees to commit various improprieties, including claiming excessive overtime and travel costs.[2] Subsequently, we received information that one employee (employee A) continued to claim excessive amounts of overtime. We investigated and substantiated this and other improprieties.

Finding #1: Despite prior knowledge, OES continued to pay employee A for his commute.

State policy prohibits state agencies from paying employees for time spent commuting from their home to the work site. Even though OES became aware that this was occurring as early as November 1998, it continued to allow employee A to claim his commute time, which contributed, in part, to the extraordinary amount of overtime he subsequently received. Specifically, during the fiscal year July 1, 1999, through June 30, 2000, employee A received approximately $100,207 in wages, of which $35,743, or 36 percent, was overtime pay. For the next fiscal year, July 1, 2000, through June 30, 2001, he was paid approximately $107,137, of which $40,523, or 38 percent, was overtime.

[1] Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2004, this is the date of the auditee's latest response.

[2] When we notified the director of OES in 2000 that we would be investigating the allegations made at that time, he informed us the CHP had begun a similar investigation at OES's request. To avoid duplicating investigative efforts, we met and coordinated with the CHP. We reported these improprieties in investigative report I2000-1.

Although much of employee A's overtime related to emergency events, nearly half was associated with nonemergency activities such as meetings or training classes. For example, of 815 hours of overtime employee A claimed in fiscal year 1999–2000, 370 hours, or approximately 45 percent, was for nonemergency events. In fiscal year 2000–01, he claimed 862 hours of overtime, of which 390 hours, or about 45 percent, pertained to nonemergency activities.

Finding #2: Employee A may not have been told to stop claiming his commute time.

Employee A and his managers have provided conflicting information regarding whether he was told to stop claiming his commute time. In July 1999, as our prior investigation drew to a close, we spoke with the former manager of the fire and rescue branch about the matter.[3] He told us that it was his understanding that employee A had been told that he no longer could claim his commute time and that he had stopped doing so. During our current investigation, employee A told us that it had always been his understanding that his home was his designated headquarters and, as a result, he claimed the time it took him to drive from his home to locations within his assigned work area. He added that to compensate for this, he sometimes did not claim all the time he spent conducting state business, such as when he worked late or responded to e-mail messages or pages on his days off. It is unclear to us why, if employee A believed this arrangement was appropriate, he felt he needed to compensate in some way for charging commute time as work hours. Regardless, we found no written evidence that OES instructed the employee that he no longer could claim his commute.

Employee A not only continued to claim his commute time, but it appears that OES never intended to prevent him from claiming this time unless it could reassign him to a work area closer to his home. In a letter dated April 7, 1999, the former manager thanked the chief of a fire district located within employee A's work area for offering OES the ability to locate one of its employees, employee A, at the fire district's headquarters. However, the former manager added, "We have reevaluated our situation and do not currently plan to relocate [employee A's] office from his current home office at this time." OES allowed the abuse to continue by declining the offer to move the employee's office from his home to a more central location within his assigned work area.

[3] This manager retired from OES effective March 30, 2001.

Finding #3: OES entered into a questionable agreement with employee A's bargaining unit.

On April 7, 1999, the same day OES formally rejected the chance to relocate employee A's office to a location within his assigned work area, OES entered into a questionable agreement with employee A's bargaining unit. Further, not only did OES enter into this questionable agreement with employee A's bargaining unit—an agreement that the current manager of the fire and rescue branch believes permitted the employee to continue to claim his commute—but it also did not provide the Department of Personnel Administration (DPA) an opportunity to review and approve the agreement as required. When we asked the appropriate DPA official to review the agreement, he questioned its appropriateness and said he considered it invalid.

Finding #4: The Fire and Rescue Branch still does not adhere to administrative controls concerning overtime.

Because the Fire and Rescue Branch (branch) failed to follow its own administrative controls concerning overtime, employees have continued to incur nonemergency overtime that lacked advance authorization. In an attempt to address the past failure of the branch to control excessive nonemergency overtime and related expenses, OES reported to us on February 10, 1999, that it had implemented an administrative system that required employees in the branch to submit in a timely manner various documents that included but were not limited to a monthly calendar of planned activities, overtime authorization and claim forms, authorization for on-call hours, and absence and time reports. OES reported that supervisors would compare each document with previously approved authorizations and individual planning documents to ensure agreement and to continuously monitor overtime use and travel expenses. However, one supervisor responsible for performing these control functions admitted that some employees under his supervision had not submitted the appropriate documents by the third working day of each month, as required. As a result, the supervisor said that there might have been instances when he was not able to review and approve planned overtime and travel incurred by employees under his supervision.

Although we did not perform an extensive review of the records of each employee in the branch, we did note several instances in which employees did not receive advance approval of nonemergency overtime. For instance, during July 1999, employee A claimed 84.5 hours of overtime, 73 of which related

to nonemergency events. However, none of the documents we obtained from the branch show that employee A received prior approval for the nonemergency overtime he claimed. In June 2000, of 99.5 hours of overtime claimed by employee A, 60.5 hours were nonemergency overtime. Again, the documents we obtained did not show that employee A obtained prior authorization to work the overtime. In June 2001, another employee, employee B, claimed 43.75 hours of overtime, all for nonemergency events. Yet none of the documents we reviewed indicated that he had received prior approval for the overtime. Given that employee A and the rest of the branch historically have incurred significant amounts of nonemergency overtime, we believe it would be prudent for OES to follow its own administrative procedures designed to monitor and control overtime and travel costs.[4]

OES Action: Corrective action taken.

OES reported that the unresolved supervisory and administrative issues associated with the branch were a result of miscommunications during changes to branch management or inadequate training, but that these issues have now been addressed. Employee A has been reassigned to a work area where he lives. OES also reported that it has established administrative controls concerning overtime authorization and that it has counseled all branch employees that nonemergency overtime will not be incurred without prior authorization.

[4] We previously reported that only 41 percent of overtime claimed by employees at the branch from November 1996 through June 1997 related directly to emergency conditions.

GOVERNOR'S OFFICE OF EMERGENCY SERVICES

Its Oversight of the State's Emergency Plans and Procedures Needs Improvement While Its Future Ability to Respond to Emergencies May Be Hampered by Aging Equipment and Funding Concerns

REPORT NUMBER 2002-113, JULY 2003

Governor's Office of Emergency Services' response as of September 2003

Audit Highlights . . .

Our review of the Governor's Office of Emergency Services' (OES) and counties' ability to coordinate and respond to multijurisdictional and multiagency emergencies revealed the following:

- ☑ *OES lacks a formal process to regularly review and update the State Emergency Plan and its related annexes.*
- ☑ *OES does not consistently perform activities needed to evaluate and improve its coordination of emergency responses under the Standardized Emergency Management System.*
- ☑ *Clarification of the roles and responsibilities of the State's Office of Homeland Security and OES would be beneficial.*
- ☑ *With aging equipment and other equipment not in place, OES's ability to task its own resources during an emergency may be limited.*

The Joint Legislative Audit Committee (committee) requested that the Bureau of State Audits (bureau) review and assess the Governor's Office of Emergency Services' (OES) policies and procedures for assessing and coordinating multijurisdictional and multiagency responses to emergencies under the Standardized Emergency Management System (SEMS) and the emergency plan. Further, the committee requested the bureau to determine if OES is maintaining the emergency plan as required by law and whether a sample of local government emergency operation centers (EOCs) are adequately prepared to respond to emergencies following SEMS. We found that the State's emergency plan and related annexes provide adequate guidance to agencies responding to multijurisdictional emergencies, but that OES lacks a formal process to regularly evaluate and update these plans. Additionally, OES is not consistently evaluating the use of SEMS by preparing statutorily required after-action reports following all declared disasters. Also, OES has had difficulty in acquiring and maintaining emergency response equipment due to what it asserts is inadequate funding. Finally, our review of six county EOCs found that they had adequate plans and training to prepare for emergencies. However, OES's recent survey of all county EOCs reveals that some counties are in need of potentially costly upgrades to improve their ability to respond to emergencies.

Finding #1: OES has not established a formal process to regularly evaluate and update the state emergency plan and related annexes.

Although we found that the State's emergency plan and related annexes adequately guide agencies to respond to emergencies, OES lacks a formal process to regularly evaluate and update these documents as necessary. OES indicates that previous emergency plan updates were made in 1959, 1984, 1989, 1998, and 2003. OES's review of the plan in 2003 was part of a federal effort to ensure that the emergency plan is current. When we asked whether OES regularly updates the emergency plan and related annexes, the director of OES's Planning and Technological Assistance Branch explained that they do not, but that they are updated when changes in state or federal laws impact emergency management, or when changes in regulations, policies, or significant procedures occur. Although OES has not established a formal process to regularly review the emergency plan and its related annexes, other states regularly update their plans so that they may incorporate lessons learned into their plans. Absent a formal and regular evaluation process for the emergency plan and its related annexes, the State's emergency plan and annexes may not reflect current practices or provide sufficient guidance during an emergency.

To ensure that the emergency plan and its related annexes are regularly evaluated and updated when necessary, we recommended that OES develop and follow formal procedures for conducting regular assessments of these plans to determine if updates are required.

OES Action: Partial corrective action taken.

OES indicates it is in the process of revising the plans review policy in the OES Policy and Procedures Manual to incorporate review and maintenance of the State's emergency plan. The revised policy will establish a formal time frame for review and progressive maintenance of the State's emergency plan based upon a review checklist, which is under development. The checklist includes planning criteria from multiple state and federal publications that focus on preparedness and response planning considerations.

Finding #2: OES has not consistently evaluated the use of the SEMS.

OES is missing important opportunities to identify and make improvements to SEMS. This is because OES fails to consistently and adequately prepare, or follow up on, the statutorily required

after-action reports following declared disasters to incorporate lessons learned during proclaimed emergencies. OES also does not follow its own policies of maintaining SEMS through regular meetings of its SEMS advisory board and technical group—two user groups that are intended to review SEMS issues and make recommendations for improvement. Since SEMS establishes the organizational framework through which multiple agencies can jointly respond to an emergency, it seems reasonable to expect OES to take a more proactive role in ensuring that this critical element of California's emergency response effort is consistently evaluated for further improvements and enhancements.

To ensure that SEMS remains a workable method to respond to emergencies, OES should more consistently evaluate its use and identify areas of weaknesses and needed improvements. Specifically, OES should do the following:

- Institute internal controls to ensure it receives after-action reports from all responding entities to an emergency, such as requiring after-action reports prior to reimbursing local agencies for response-related personnel costs. Further, OES should ensure that the reports by local governments evaluate the use of SEMS for any needed improvements and enhancements.

- Prepare after-action reports after each declared disaster that review emergency response and recovery activities.

- Develop a system that tracks weaknesses noted in the after-action reports, which unit is responsible for correcting those weaknesses, and what corrective actions were taken for each weakness.

- Reconvene the SEMS advisory board and technical group to foster more communication on the use of SEMS, and to provide OES advice and recommendations on SEMS.

OES Action: Partial corrective action taken.

OES is developing policies and procedures for development of after-action reports to consistently evaluate SEMS. The policies and procedures will address automatic assignment of responsibilities for the after-action reports, required and optional content, process for evaluating SEMS compliance, recommendations for follow-up and change, and a clear indication of those declared disasters that do not require an after-action report.

OES indicates that SEMS issues are addressed at ongoing statewide forums, such as the Statewide Emergency Planning Committee, the OES Fire and Rescue Advisory Committee/ FIRESCOPE Board of Directors, and other related meetings. Additionally, OES continues to convene the Mutual Aid Regional Advisory Committees in all six mutual aid regions where SEMS-related issues are identified and discussed. Any significant issue will be raised to OES's management for evaluation and appropriate action, including convening the SEMS advisory board and/or the technical group.

Finding #3: Data problems prevent OES from evaluating how well it coordinates resources during emergencies.

Inaccurate and missing data in its Response Information Management System (RIMS) prevents OES from evaluating how well it coordinates responses during emergencies. Because OES is not using RIMS to capture accurate mission approval times and resource arrival times, it lacks data to evaluate how well it coordinates emergency responses. Mission approval times are important because the faster OES approves a resource request, the faster resources are likely to arrive on scene. Our review of RIMS data revealed that 13 out of 27 sampled mission approvals were late, and we were unable to determine the resource approval time for two of the requests. Furthermore, our testing showed that RIMS users did not report resource arrival times for 24 out of 27 resource requests in our sample. If OES had this information, it could evaluate whether resources are arriving promptly to emergency sites while better tracking the resources tasked to emergencies.

We recommended that OES take steps to ensure that it can accurately track how long it takes to approve resource requests and pinpoint when those resources arrived at the emergency.

OES Action: Pending.

OES indicates it will convene a meeting of an internal RIMS Working Group to address these findings and assess how to incorporate our recommendations. The first meeting will be held on October 20, 2003, where the group will begin to evaluate possible RIMS upgrades, discuss SEMS forms and reports improvements, and propose mission tasking application modifications. The group will also discuss system

changes to ensure that RIMS data is accurate and consistent. Following discussions with OES in November, we learned that the October 20th meeting took place.

The group will also determine how best to utilize RIMS for the Fire and Rescue Branch and explore all available options to meet its needs. Future plans include expanding the group to local government representatives for their input, as well as surveying RIMS users for system improvement ideas.

Finding #4: OES needs to ensure key staff are properly trained.

Citing a lack of funding, OES has not conducted a needs assessment to determine the training needs for management and workers that staff state and regional centers. OES has developed an individual training plan (training plan) program; however, OES had only developed training plans for seven of the 14 state center staff we reviewed. Although the training plan can be a useful tool, because OES does not use it for all state center staff and does not provide guidance to all supervisors preparing training plans, OES cannot ensure that all state center staff receive the training they need to effectively respond to emergencies.

To ensure that state agencies—including itself—are adequately prepared to respond to emergencies within the State, OES should determine the most critical training that emergency operations center staff, at state and regional levels, need in order to fulfill their duties, and then allocate existing funding or seek the additional funding it needs to deliver the training.

OES Action: Partial corrective action taken.

OES indicates that its training policy was revised in June 2003. The policy, in part, outlines "core competencies" for all OES staff, which include principles of emergency management, SEMS (introduction and EOC functions), and RIMS. The training policy has been provided to all branch managers who have been asked to use it in the development of their staff's individual training plans.

Finding #5: Clarification of the roles and responsibilities of OHS and OES would be beneficial.

In February 2003, the governor established the Office of Homeland Security (OHS) within the Office of the Governor. Some of the responsibilities assigned to OHS by the executive

order and to the director of OES appear to have the potential to overlap. For example, under the California Emergency Services Act, the director of OES is assigned the responsibility of coordinating the emergency activities of all state agencies during a state of war emergency or other state emergency, and every state agency and officer is required to cooperate with the director in rendering assistance. However, under the executive order, OHS is assigned the responsibility of coordinating security efforts of all departments and agencies of the State and the activities of all state agencies pertaining to terrorism-related issues, and is designated as the principal point of contact for the governor. Moreover, the director of OES is required to report to the governor through OHS, but that reporting function is not limited to issues related to state security or terrorism, and thus appears to require OES to make all reports to the governor through OHS.

To ensure the State is adequately prepared to address emergencies and to avoid misunderstandings, OHS should work with the governor on how best to clarify the roles and responsibilities of OHS and OES.

OES Action: Partial corrective action taken.

OHS indicates that it continues to work with OES and the Governor's Office to clarify the roles and responsibilities, but offers no specific information about its efforts.

Finding #6: Equipment concerns may impact OES's future ability to respond to emergencies.

OES has had difficulty acquiring and maintaining emergency response and communication equipment due to what it asserts is inadequate funding. Specifically, 26 percent of OES's active fire engines have been in service for longer than the 17-year useful life that OES has adopted. OES also has no heavy urban search and rescue vehicles, which help extricate people from collapsed structures, despite a statutory mandate to obtain these vehicles. With aging equipment, and other equipment not in place, OES's ability to task its own resources during an emergency may be limited. OES has recently acquired sufficient funding to replace its aging fire engines and has taken steps to replace older fire engines, but its request for 18 heavy urban search and rescue vehicles was not funded. However, OES has not performed a current needs assessment to determine how many heavy urban search and rescue vehicles it needs in order to respond to an emergency within one hour, as required under statute.

Further, OES has not tried to establish the thermal imaging equipment-purchasing program required by law. OES's failure to take the statutorily required steps to establish this program may have denied local governments from taking advantage of an opportunity to obtain this equipment at a lower cost than they could obtain on their own. Finally, OES is facing a problem with its Operational Area Satellite Information System (OASIS), a satellite network that serves as a backup communications system, which is degrading and threatens OES's ability to coordinate with local governments should phone communications become disabled during a major emergency.

To ensure that it and local governments have the equipment to adequately respond to emergencies, OES should take the following actions:

- For its fire engine program, OES should continue with its schedule for replacing older and poor performing fire engines in the fleet.

- OES should perform a needs analysis to determine the number of heavy urban search and rescue units that are required to respond to a major earthquake. If this needs analysis concludes that additional units are required, OES should submit a budget change proposal to acquire this equipment, and it should develop a maintenance and replacement schedule for this equipment.

- OES should take the required steps to establish a thermal imaging equipment-purchasing program, including determining the interest among local governments in purchasing this equipment. However, if OES determines that it cannot identify funding sources to pay its share, OES should explore the use of the State's buying power to enter into a contract that allows local governments to purchase this equipment at a lower cost.

OES should study options to extend the life of or replace OASIS. However, if it concludes that OASIS should be replaced, OES should justify this replacement by demonstrating that maintenance costs are exorbitant and that OASIS is down for excessive periods for repair.

OES Action: Partial corrective action taken.

OES states that it has taken the following actions regarding the recommendations above:

- OES indicates that it is taking possession of 21 new engines in accordance with the three-year procurement contract that was initiated in fiscal year 2000–01. Further, OES plans to obtain an additional 21 engines over the next three years. According to OES, all of its fire engines continue to undergo annual safety inspections, as well as after each fire incident.
- OES indicates that it will update its initial needs analysis for heavy rescue units in the State by conducting a current assessment of the statewide capability. However, OES states that it is restricted from submitting budget change proposals for more heavy rescue units, but will explore funding through other sources.
- OES plans to convene a committee meeting in January 2004 to discuss the legislative mandate for thermal imaging equipment. OES will identify further corrective action following this committee meeting.
- OES indicates that it has now executed a new three-year maintenance contract for its OASIS system. The contract period covers January 2003 through December 2005. OES states that it will continue to seek options for upgrading and extending the life of OASIS through the federal grant process, partnering efforts with other state and local agencies, and the State's budget change proposal process.

TERRORISM READINESS

The Office of Homeland Security, Governor's Office of Emergency Services, and California National Guard Need to Improve Their Readiness to Address Terrorism

Audit Highlights . . .

Our review of the Governor's Office of Emergency Services' (OES) and the California National Guard's (National Guard) terrorism readiness activities revealed:

- ☑ *Both agencies have developed plans that adequately guide their response to terrorist events, but OES has not included a prevention element in the State's terrorism response plan.*
- ☑ *OES has not always identified the critical training that staff in the operations centers need to effectively complete their duties.*
- ☑ *OES does not regularly develop and administer state-level terrorism readiness exercises with other state and local agencies, as its terrorism response plan requires.*
- ☑ *Clarification of the roles and responsibilities of the State's Office of Homeland Security and OES would be beneficial.*

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REPORT NUMBER 2002-117, JULY 2003

Office of Homeland Security, Governor's Office of Emergency Services, and California National Guard responses as of September 2003

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the terrorism readiness efforts of the Governor's Office of Emergency Services (OES) and the California National Guard (National Guard). Specifically, the audit committee asked that we review and evaluate the terrorism prevention and response plans, policies, and procedures of these agencies and determine whether the plans are periodically updated and contain sufficient guidance. It also asked that we determine whether OES and the National Guard have provided sufficient training to their staff to effectively respond to terrorism activities and assess how the training compares to best practices or other reasonable approaches. The audit committee further requested that we determine whether both agencies take advantage of all state and federal funding for terrorism readiness. Finally, the audit committee asked that we determine whether the National Guard's recruitment and retention practices and staffing levels impact its readiness to respond to terrorism activities or its ability to attract qualified personnel for terrorism readiness positions.

Finding #1: The terrorism response plan guides the State's response but does not include ways to help prevent terrorism.

Although the State Emergency Plan (emergency plan) and terrorism response plan adequately define the roles and responsibilities of numerous state and local agencies in responding to various emergencies, including terrorism, they do not address how the State could help prevent terrorist attacks from occurring. Lacking in the terrorism response plan is guidance for terrorism prevention. One reason for this deficiency may be that

☑ *Although the National Guard generally relies on its members' military training to respond to terrorism missions, it has not provided all of the training its staff in its Joint Operations Center needs to adequately respond to these missions.*

☑ *The National Guard believes it has not had sufficient funding to participate in exercises involving other state and local emergency response agencies.*

the Legislature did not envision a prevention role when it established OES in the California Emergency Services Act (act). Rather, the act sets the focus of OES as coordinating the State's response activities. However, the State needs to plan how it can help prevent terrorist events from occurring to best protect the citizens of the State against the consequences of such events. Acknowledging this void in the current terrorism response plan, the director of the Office of Homeland Security (OHS) stated that his office plans to revise the current state plan to make it more concise and include a prevention component.

To ensure that the State is adequately prepared to address terrorist threats, OHS should continue its plans to develop a state plan on terrorism that includes a prevention element

OHS Action: Corrective action taken.

OHS states that it is identifying key prevention elements that should be incorporated into the terrorism response plan.

Finding #2: OES has no formal process to periodically review and update the terrorism response plan.

OES lacks a formal process to regularly review the terrorism response plan and update it as determined necessary. Rather, OES staff state that they update the terrorism response plan when changes in statute affecting emergency management or changes occur in regulations, policies, or significant procedures. Although OES has not established a formal process to regularly review the terrorism response plan, other organizations and states we contacted do regularly update and incorporate lessons learned into their plans. Without an established process to regularly review the plan, OES cannot ensure that it remains current and adequately protects the State. Furthermore, OES would make its assessment more consistent and effective if it developed a checklist to guide its efforts in evaluating the terrorism response plan.

OHS and OES should ensure that the state plan addressing terrorism is reviewed on a regular basis and updated as determined necessary to ensure that it adequately addresses current threats and benefits from the lessons learned in actual terrorist readiness events occurring both in California and nationwide. Additionally, they should develop a checklist to guide periodic evaluations of the state plan addressing terrorism to ensure that such assessments are consistent and effective.

OES Action: Corrective action taken.

OES states that it is developing formal procedures to review, assess, and update the emergency plan and its related annexes, including the terrorism response plan. OES also states that it is developing a checklist to guide its reviews.

Finding #3: OES has not identified the training needs for all of its staff.

OES has not conducted a needs assessment to determine the training requirements for all personnel in its state and regional operations centers. Although OES does develop individual training plans for some of its staff, which identify an individual employee's career goals and objectives, it does not prepare them for all staff working in state and regional operations centers. Furthermore, OES does not provide guidance to all supervisors preparing the training plans to ensure that they include training related to core competencies. Core competencies are the key skills employees need to possess to perform their assigned duties.

To ensure that state agencies, including OES, are adequately prepared to respond to terrorist events occurring within the State, OES should identify the most critical training required by staff at state and regional operational centers and then allocate existing funding or seek additional funding it needs to deliver the training.

OES Action: Corrective action taken.

OES states that it has identified the core competencies for all OES staff and has developed a training policy to guide managers as they develop training plans for OES staff.

Finding #4: OES has not conducted state-level terrorism readiness exercises as called for in its terrorism response plan.

With the exception of federally or state mandated exercises associated with nuclear power plants and hospitals, the State does not presently have an established program to provide exercises to ensure that state agencies are prepared to respond to terrorist events. According to OES, it has not regularly developed and administered terrorism readiness exercises because it is not funded to do so. However, it has not requested state funding to conduct the exercises. OES has participated in terrorism readiness exercises when other agencies have held them, and staff have received training through activation experiences.

However, these activities would not necessarily test and enhance the capabilities of state agencies, local governments, and related entities to prepare for, respond to, and recover from terrorist events as called for in the terrorism response plan. OHS has recently decided that the California National Guard should be responsible for coordinating state-level exercises, awarding $1.6 million in federal funds to them. Because of the unique role that OES plays in coordinating emergencies, it will be important for OES to work with the National Guard to establish an effective exercise program.

To ensure that state agencies, including OES, are adequately prepared to respond to terrorist events occurring within the State, OES should assist the National Guard in providing state-level terrorism readiness exercises.

OES Action: Corrective action taken.

OES states that it is developing a functional exercise for the state and regional operations centers. It also states that it will continue to work with the National Guard in developing terrorism readiness exercises.

Finding #5: The effect of budget cuts are uncertain.

An OES analysis stated that budget cuts it is required to sustain due to the current state budget crisis will severely hinder its ability to fulfill its overall mission, including terrorism readiness. However, since February 2003, OES is to report to the Governor's Office through the OHS director, and the OHS director told us he believes that OES can meet its statutory mission despite budget cuts incurred as of June 2003. To optimize its efficiency, the OHS director intends to assess the OES organization to identify more efficient ways for OES to fulfill its statutory responsibilities, focusing its resources on mission-related activities.

To ensure that the State is adequately prepared to address terrorist threats, OHS should continue its plans to thoroughly assess OES functions to determine how it can optimize its efficiency.

OHS Action: Pending.

OHS states that it continues to assess OES functions to evaluate how best to address the budget cuts and that once the 2004–05 budget is finalized, it will be better able to address this finding.

Finding #6: Clarification of the roles and responsibilities of OHS and OES would be beneficial.

The authority provided to OES under the act and the authority provided to OHS by the governor's February 2003 executive order appear to have the potential to overlap. Further, the directors of the two offices appear to have differing views on their roles and responsibilities. A lack of clarity in their respective roles and responsibilities could adversely affect the State's ability to respond to emergencies, such as a terrorist event.

To ensure that the State is adequately prepared to address terrorist threats, OHS should work with the governor on how best to clarify the roles and responsibilities of OHS and OES.

OHS Action: Pending.

OHS states that it is working with OES and the Governor's Office to clarify the roles and responsibilities of the two offices.

Finding #7: Joint Operations Center staff have not yet completed all the training they need to effectively coordinate missions.

The Joint Operations Center is responsible for receiving state missions from OES and developing and overseeing the National Guard's response to requests for its services. In June 2002, the Joint Operations Center identified training it believes its staff need to adequately respond to state emergencies. However, 32 of the 38 members required to take specific courses had received less than half the designated training. According to the National Guard, lack of funding and limited availability of classes have hindered its ability to train its Joint Operations Center staff in the identified areas. Without proper training, the ability of the National Guard to respond promptly and effectively to state missions may deteriorate.

To ensure that its members are adequately trained to respond to terrorism missions, the National Guard should determine the most critical training its Joint Operations Center staff need to fulfill their duties and then allocate existing funding or seek the needed funding to provide the training, documenting why it is needed.

National Guard Action: Corrective action taken.

The National Guard states that it has developed a plan that identifies the training needed by the various members of the Joint Operations Center. The National Guard adds that it has not received any additional funding to provide training to members of the Joint Operations Center.

Finding #8: The Army Guard Division does not provide required terrorism awareness training to its members.

The National Guard's Army Guard Division does not provide terrorism awareness training required by U.S. Army regulations as part of its terrorism readiness force protection (force protection) program. According to the commanders of the Army Guard units we visited, the reason they have not fully implemented the terrorism awareness training is that they have not received the guidance to implement it. Further, although the regulation provides that one way the units can offer the required training is through an approved web-based course, the director of the Joint Operations Center stated that his office had been unaware of such a course until recently. However, while visiting an Air Guard unit in April 2003, we discovered that it had been using a Web-based course to fulfill the requirement for terrorism awareness training since June 2002. Therefore, despite its responsibility for implementing the force protection program in both the Air Guard and Army Guard divisions, the Joint Operations Center was unaware of the practices of the Air Guard Division that could have benefited the Army Guard Division. Had the Joint Operations Center been more aware of the training being utilized in the Air Guard Division, it could have identified this best practice and shared it with the Army Guard Division.

The National Guard should develop guidance for its Army Guard Division to implement its terrorism readiness force protection program. Additionally, it should ensure that its Joint Staff Division, including the Joint Operations Center, share best practices between its Air Guard and Army Guard divisions.

National Guard Action: Partial corrective action taken.

The National Guard states that the Army Guard Division is developing a regulation to implement its terrorism readiness force protection program, commenting that it should be fully implemented by December 2004. Additionally, the National Guard states that the Chiefs of Staff for the Army, Air, and Joint Staff divisions meet each week and include a discussion of best practices among the divisions.

Finding #9: The National Guard would benefit from increased state-level terrorism exercises

The National Guard believes that it has not had sufficient opportunities to participate in exercises with other state and local emergency response agencies. In June 2003, OHS advised us that it has now allocated $1.6 million in federal funding to the National Guard to coordinate terrorism readiness exercises that include both state agencies and rural jurisdictions. Therefore, the National Guard should soon be able to participate in terrorism readiness exercises with other state and local emergency response agencies.

The National Guard should use the recently awarded funds from OHS to identify the type and frequency of state-level exercises responding to terrorist events that the State needs to be adequately prepared. The National Guard should then provide the exercises it has identified.

National Guard Action: Partial corrective action taken.

The National Guard states that it has formed an exercise management team consisting of staff from the National Guard and other state and local agencies that have first responder responsibilities. With current grant funding, the National Guard plans to coordinate four regional and one statewide exercise by October 2004.

ENTERPRISE LICENSING AGREEMENT

The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars

Audit Highlights . . .

On May 31, 2001, the State entered into a six-year enterprise licensing agreement (ELA), a contract worth almost $95 million, to authorize up to 270,000 state employees to use Oracle database software and to provide maintenance support.

Our audit of this acquisition revealed the following:

- ☑ *By broadly licensing software, a buyer that has many users, such as the State, can achieve significant volume discounts.*
- ☑ *The State proceeded with the ELA even though a survey of departments disclosed limited demand for Oracle products.*
- ☑ *The departments of General Services, Information Technology, and Finance approved the ELA without validating Logicon's cost savings projections; unfortunately, these projections proved to be significantly overstated.*
- ☑ *Logicon apparently stands to receive more than $28 million as a result of the ELA.*

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REPORT NUMBER 2001-128, APRIL 2002

Department of General Services and Department of Finance's responses as of April 2003[1]

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to examine the State's contracting practices in entering into the enterprise licensing agreement (ELA) with Oracle. Specifically, the bureau was asked to review the sole-source justification for the ELA and the roles of the Department of General Services (General Services), the Department of Information Technology (DOIT), and the Department of Finance (Finance) in developing and executing the ELA. We were also asked to review the terms of the agreement and determine whether they were in the best interests of the State and assess the methods used to justify the technical and business need for the ELA.

Further, we were asked to identify the fixed and variable costs of the ELA, the funding sources that will pay for it, and the reasonableness of the projected savings from the ELA. Lastly, the audit committee requested we obtain a legal opinion on whether the contract is null and void if it was executed in violation of state law.

Finding #1: Surveys conducted by DOIT and Finance indicated a limited need for Oracle database licenses.

The three departments involved in the ELA—DOIT, General Services, and Finance failed to conduct a comprehensive analysis to gauge or confirm the level of statewide interest in the ELA. However, at least two months before the ELA was executed, DOIT ignored preliminary survey data that strongly suggested most departments had no immediate need for Oracle database licenses. Specifically, of the 127 surveys it sent to state entities,

[1] The Department of Information Technology was sunset on July 1, 2002.

- ☑ *Nearly 10 months after the ELA was approved, no state departments had acquired the new licenses, which may be due to the fact that General Services had not issued instructions to departments on how to do so.*
- ☑ *General Services used an inexperienced negotiating team and limited the involvement of legal counsel in the ELA contract. As a result, many contract terms and conditions necessary to protect the State are vague or missing.*
- ☑ *Our legal consultant has advised us that a court might conclude that the ELA contract with Oracle is not enforceable as a valid state contract because it may not fall within an exception to the State's competitive bidding requirements.*

DOIT received only 21 responses, five of which indicated a possible interest in purchasing any additional Oracle products under a consolidated agreement in the near future.

In November 2001, five months after the ELA was approved, Finance sent out another survey to assess the need for Oracle database licensure and to establish a basis for allocating the cost of the ELA. This survey explicitly required all departments to respond. Preliminary survey results indicated that for the 12 state departments with the largest number of authorized positions, 11 use Oracle database products to some extent. However, while the ELA will cover up to 270,000 users—more than the total number of state employees—according to the survey, 113,000 of the authorized positions at just these 11 state departments will not use the Oracle database software.

Finance administered the survey as a preliminary step to appropriately allocate the ELA's cost among the various departments, and the information obtained on current and planned use of the Oracle enterprise database licensure was to be used to develop a cost allocation model. However, as of April 2002, 10 months after the ELA was approved, the analysis of the survey was incomplete. Furthermore, state departments have not been informed of how to acquire the database licenses using the ELA. Thus, it is not surprising that no state department had acquired new licenses under the ELA as of the end of March 2002.

Finance's survey was to provide necessary information about whether state departments have purchased any Oracle database licenses or entered into any maintenance contracts since the ELA was signed. The absence of an allocation model along with the lack of any specific pricing information or ordering instructions informing departments how to purchase the database licenses through the agreement may further reduce any cost savings or utility from the ELA. In reviewing the preliminary results of the November 2001 survey, we identified 12 state departments that have entered into their own maintenance contracts with Oracle—totaling $1.1 million for products covered by the ELA—since it was signed on May 31, 2001.

In order to take full advantage of the Oracle ELA, we recommended that Finance complete its survey and develop a method to allocate the ELA's cost to departments.

Finance Action: None.

Finance has elected not to complete its survey since the ELA was rescinded in July 2002.

Finding #2: DOIT and Finance did not adequately evaluate the ELA proposal's merits.

The State negotiated and ultimately approved the ELA proposal without sufficient technical guidance, assessment of need, or verification of projected benefits. According to officials at DOIT, General Services, and Finance, the State had never before considered a statewide software purchase, nor did it have any specific guidance in identifying the extent of the need for the software and in negotiating the key provisions to include in the contract. In fact, DOIT had looked at the concept of statewide software licensing as early as June 2000, when it hired Logicon Inc. (Logicon) to research and present information on enterprise licensing. Nevertheless, DOIT and Finance routinely evaluate IT proposals, including those involving software purchases. Although both possessed the expertise needed to evaluate aspects of the ELA proposal—DOIT the need to license 270,000 users and Finance the cost projections—neither did so, citing a lack of suitable procedures and inadequate time. To its credit, Finance's Technology Investment Review Unit (TIRU) identified specific concerns with the ELA proposal, and on May 10, 2001, communicated these concerns to the directors of Finance and DOIT. It also recommended that the proposal be postponed until the following year, giving the State a chance to develop appropriate policy. However, TIRU's concerns and recommendation were not heeded. As a result, the State committed almost $95 million without knowing whether the costs and benefits of the ELA were justified.

Before pursuing any future enterprise agreements, we recommended the State take the following actions:

- DOIT, Finance, and General Services should seek legislation establishing the authority to enter into an ELA that protects the State's interests and clarifies each department's respective role and responsibility in the process.

- Finance should notify the Legislature at least 30 days in advance of any state department executing any future ELA.

- DOIT should continue its efforts to create a statewide IT inventory, including software.

Finance, General Services, and DOIT Action: Partial corrective action taken.

Finance, General Services, and DOIT developed a draft process for statewide software licenses that defined specific roles and responsibilities for the three departments and addressed analytical and approval procedures. However, because of the closing of DOIT and the adoption of Section 11.10 of the Budget Act of 2002, the process was not formally approved.

As proposed by the governor, Section 11.10 of the Budget Act of 2002 was adopted and will fulfill some of the recommendations. Specifically, Section 11.10 requires a 30-day legislative notification before any department can enter into a statewide software license agreement of $1 million or more, regardless of future costs or savings. Additionally, the agreement must be reviewed by Finance. This section also states that any department considering entering into such an agreement is required to submit to Finance a business plan with specific components, including an analysis of base and current usage of the license, rationale for statewide license versus an alternative type of agreement, cost-benefit analysis, and funding plan.

DOIT ceased to exist on July 1, 2002, thereby ending its efforts to create a statewide IT inventory. Currently, no other state department has been assigned the responsibility to continue these efforts.

Finding #3: The Oracle ELA could cost the State added millions in taxpayer resources.

The Oracle ELA could cost the State $41 million more in database license and maintenance support than what the two would have cost in the absence of the contract. This is because the State did not validate the projections of costs and savings prepared by Logicon, who, acting in an undisclosed capacity as an Oracle reseller or licensing agent, would benefit significantly from the contract. Logicon, whose only role according to the contract was as the designated lender, and who apparently stood to make more than $28 million as a result of the ELA, developed the business case analysis General Services used to justify the State's decision to contract with Oracle. However, Logicon's analysis, which projected a savings to the State of $111 million over

10 years, was seriously flawed. Specifically, it was based on costs that should have been excluded because they were outside the ELA's coverage or did not follow the analysis' stated methodology. Further, Logicon's calculations contained numerous errors and many of its assumptions were questionable.

To ensure that future enterprise agreements meet the State's best interests, we recommended DOIT and Finance develop policies and procedures on how to evaluate future ELAs. To be effective, one state department needs to take responsibility for developing and justifying the ELA proposal.

Finance, General Services, and DOIT Action: Corrective action taken.

Finance, General Services, and DOIT developed a draft process for statewide software licenses that defined specific roles and responsibilities for the three departments and addressed analytical and approval procedures. However, because of the closing of DOIT and the adoption of Section 11.10 of the Budget Act of 2002, the process was not formally approved. Further, information technology experts have informed Finance and General Services that ELAs are not generally considered a best practice, especially with state governments. These experts state that such an environment is better suited to a volume purchase agreement (VPA). According to Finance, in the event that a VPA is being considered, General Services has agreed to take lead responsibility.

Finding #4: The State did little to protect itself against risks associated with the contract.

The State rushed into the Oracle ELA without negotiating strong provisions to guard against the risks inherent in long-term software contracts. The term of these types of contracts generally ranges between three to five years, partly because of the rapidly changing nature of the software industry. However, the State's contract with Oracle was for six years with a maintenance option for four more years. Our technical consultant observed that by entering into such a large long-term contract, the State increased risks such as the following:

- The vendor going out of business, being purchased, or otherwise becoming unable to perform.

- Technology changes that leave the State with a prepaid, long-term contract for a product that has diminishing value.

- Future software upgrades that are not supported under the contract.

- Lack of funding to make all future payments required under the contract.

- Demand for the software licenses not meeting expectations.

To protect against such risks, buyers normally try to negotiate mitigating safeguards as part of the terms and conditions of a contract. For example, a buyer would normally want to ensure that contract terms clearly define the support level the vendor will provide, including how upgrades and subsequent versions of the software will be furnished at no additional cost. Unfortunately, the State's hastily negotiated contract with Oracle lacked adequate provisions to minimize these risks.

The increased risks associated with this long-term contract largely occurred because General Services failed to properly prepare for contract negotiations with Oracle. For example, General Services did not include on its negotiating team anyone with expertise in the area of software licensing agreements or anyone with an in-depth knowledge of Oracle's past business practices. Moreover, General Services' legal counsel's role in the negotiations was limited to a few hours review of the contract's terms and conditions occurring the day before and the day it was signed. Consequently, the contract does not adequately protect the State's interests.

We recommended that, before negotiating any future enterprise licensing agreements, General Services should assemble a negotiating team that possesses all the types of expertise necessary to protect the State's interests. Further, if deemed enforceable, General Services should renegotiate the contract to ensure it includes adequate protections for the State. We also recommended that the Legislature should consider requiring all IT contracts over a specified dollar amount to receive a legal review by General Services.

General Services' Action: Partial corrective action taken.

On July 23, 2002, the ELA for Oracle database licenses and maintenance support was rescinded. However, General Services stated that it would ensure sufficient resources and expertise are assigned to any future ELA proposals. If deemed necessary, this will include the use of an independent third party to review each proposed agreement. Additionally,

General Services is working on developing and delivering a comprehensive training and certification program for state contracting and purchasing officials.

In support of recommendations made on August 30, 2002, by the Governor's Task Force (task force) on Contracting and Procurement Review, an assessment was performed to determine the knowledge, skills, and abilities needed by acquisition professionals. This information was used to determine course content for a comprehensive training and certification program for state contracting and purchasing officials. General Services specifically identified the urgency for targeting training in the complex area of IT contracting.

General Services has developed a new contract and procurement review process whereby state departments doing high-risk procurements undergo an assessment review during the early stages of the contracting process. At that time, General Services determines if a contract needs developmental support, technical support, and/or legal support. General Services ensures that the type of review received is appropriate for the risk involved.

Legislative Action: None.

We are unaware of any legislative action implementing this recommendation.

Finding #5: The State's contract with Oracle may not be enforceable.

Our legal consultant has advised us that a court might find the ELA is not enforceable as a valid state contract because it may not fall within an exception to competitive bidding requirements. However, further analysis is required to understand the impact of a finding that the Oracle contract is unenforceable. For example, our legal consultant cautioned that even if a court found that the ELA contract is void for failure to comply with competitive bidding requirements, additional questions are raised by the financing arrangements for the $52.3 million dollar loan under which Logicon assigned its rights to Koch Financial Corporation (Koch Financial). Because Koch Financial apparently acted in good faith and the State has received the full consideration for the loan—the enterprise license and one year of maintenance support—under the financing provisions, Koch Financial is likely to assert that the

State is obligated to repay the loan. Also, the State has agreed to stop using the ELA's enterprise database licensure if the Legislature does not appropriate funds for the loan payments or the State does not otherwise make payment and the ELA contract is terminated. More importantly, under the ELA contract the State also agreed not to replace the Oracle license with substantially similar database licenses for one year from the termination date.

Logicon's role, actions, and compensation from the ELA also raise troubling questions about the validity of the ELA contract. Specifically, the amount of compensation Logicon has or will continue to receive—more than $28 million—for its undisclosed role in the ELA is too much to be merely compensation for being a lender and for the limited support services it will provide.

Finally, Logicon's erroneous savings projections may make the contract voidable. We arrived at vastly different numbers in reviewing the data that supports the costs and projections that Logicon presented to the State. For example, although Logicon projected that the State would save as much as $16 million during the first six years of the contract, using Logicon's data and assumptions, we project that the State could spend as much as $41 million more than it would have without the ELA.

For these reasons, we recommended that General Services should continue to study the ELA contract's validity in light of the wide disparities we identified in Logicon's projections of costs and savings and consult with the Office of the Attorney General (attorney general) on how to protect the State's best interests. General Services should also work with the attorney general in further analyzing the ELA contract; all amendments, including any and all documents pertaining to side agreements between Oracle and Logicon; and the laws and policies relating to the ELA, including the potential legal issues that this audit has identified.

General Services' Action: Corrective action taken.

As previously discussed, on July 23, 2002, the ELA with Oracle for database licenses and maintenance services was rescinded. General Services notified state departments of the rescission through the issuance of a management memo.

FEDERAL FUNDS

The State of California Takes Advantage of Available Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource

REPORT NUMBER 2002-123.2, AUGUST 2003

Departments of Finance and Health Services responses as of October 2003

Audit Highlights . . .

Our review of federal grant funding received by California found that:

- ☑ *California's share of nationwide grant funding, at 11.8 percent, was only slightly below its 12 percent share of the U.S. population.*
- ☑ *Factors beyond the State's control, such as demographics, explain much of California's relatively low share of 10 large grants.*
- ☑ *Grant formulas using out-of-date statistics reduced California's award share for another six grants.*
- ☑ *In a few cases, California policies limit federal funding, but the effect on program participants may outweigh funding considerations.*
- ☑ *California could increase its federal funding in some cases, but would have to spend more state funds to do so.*

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The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether California is maximizing the amount of federal funds it is entitled to receive for appropriation through the Budget Act. Specifically, we were asked to examine the policies, procedures, and practices state agencies use to identify and apply for federal funds. We also were asked to determine if the State is applying for and receiving the federal program funds for which it is eligible, and to identify programmatic changes to state-administered programs that could result in the receipt of additional federal funds. Finally, the audit committee asked us to examine whether the State is collecting all applicable federal funds or is forgoing or forfeiting federal funds for which it is eligible. Specifically, we found:

Finding #1: California's share of federal grants falls short of its population share, due in part to the State's demographics and federal grant formulas.

California's share of total federal grants awarded during fiscal year 2001–02 was 11.8 percent, or $42.7 billion. This share is slightly below California's 12 percent share of the nation's population (population share). For 36 of 86 grants accounting for 90 percent of total nationwide federal grant awards in fiscal year 2001–02, California's share was $5.3 billion less than an allocation based on population share alone. Grants for which California's share falls below its population share include ones in which demographics work against California, and formula grants that provide minimum funding levels to states or use out-of-date statistics. With regard to state efforts to gain federal funding, we found that state

- ☑ *In some instances, California has lost federal funds because of its noncompliance with program guidelines or by not using funds while they are available.*
- ☑ *The statewide hiring freeze and a pending 10 percent cut in personnel costs may further limit federal funds for staff.*

departments appear to use reasonable processes to identify new or expanded funding from federal grants and do not miss grant opportunities because of a lack of awareness.

Of the 36 grants for which the State's share fell below its total population share, 10 are due to California's low share of a particular demographic group. For example, California received relatively little of the federal funds awarded to rural communities for water and waste disposal systems in fiscal year 2001–02 because its rural population is low in relation to the rest of the nation. In addition, California is the country's sixth youngest state, so it received less than its total population share of grants to serve the elderly.

Funding formulas that do not allocate funds based on populations in need result in a lower percentage of grant funding for populous states such as California. Some grants are awarded based on old statistical data that no longer reflect the distribution of populations in need. For example, much of a grant for maternal and child health services is distributed according to states' 1983 share for earlier programs, for which California's share was 5.8 percent. If the entire grant were based on more current statistics, California's award for fiscal year 2001–02 would be $23.6 million higher. Other grants provide minimum funding to states without regard to need; the State Homeland Security grant, for example, distributes more than 40 percent of its funds to states on an equal basis, with the rest matching population share. For this grant, the average per resident share for California will be $4.75, far less than the $7.14 average per U.S. resident.

We recommended that as federal grants are brought up for reauthorization, the Legislature, in conjunction with the California congressional delegation, may wish to petition Congress to revise grant formulas that use out-of-date statistics to determine the share of grants awarded to the states.

Legislative Action: Legislation passed.

In September 2003, the Legislature passed an Assembly Joint Resolution requesting that the California congressional delegation use the opportunities provided by this year's reauthorization of several federal formula grant programs to attempt to relieve the disparity between the amount of taxes California pays to the federal government and the amount the State receives in return in the form of federal formula grants and other federal expenditures.

Finding #2: State and local policies have limited California's share of federal funds in a few cases.

State and local policies limit California's share of federal funds for three programs. For the Special Education–Grants to States (Special Education) grant, California's share is less than would be expected based on its number of children because of the local approach to deeming children eligible for special education services. California's federal funding for the In-Home Supportive Services program is also low because of a state program that pays legally responsible relatives to be caregivers, a type of activity that is ineligible for federal reimbursement. Another agency has proposed changing the Access for Infants and Mothers and State Children's Health Insurance (Children's Insurance) programs to increase federal grant funding. These policies have affected the State's ability to maximize the receipt of federal funds. However, we did not review the effects on stakeholders that a change in government policies for these programs would entail, effects that may outweigh funding considerations.

The State's Residual In-Home Supportive Services program, funded solely from state and county sources, has likely reduced the participation of some eligible recipients in the federally supported Personal Care Services program. Both programs provide various services to eligible aged, blind, and disabled persons who are unable to remain safely at home without this type of assistance. The Residual In-Home Supportive Services program provides additional services and serves recipients who are not eligible for the federal program. In addition, the State's program allows legally responsible relatives to be caregivers to recipients. Legally responsible relatives include spouses and parents who have a legal obligation to meet the personal care needs of their family members. The federal program, in contrast, does not allow payments to such caregivers.

The Department of Health Services (Health Services), in conjunction with the Department of Social Services, may be able to apply for a waiver under the Medical Assistance program, called Medi-Cal in California. This recently developed waiver program, called Independence Plus, may allow states to claim federal reimbursement for a portion of the expenditures for caregiver services provided by family members. The departments estimate that the State may be able to save $133 million of costs currently borne by the State's Residual In-Home Supportive Services program if this waiver is pursued. They indicated that they are jointly exploring the feasibility of this waiver.

We recommended that Health Services continue to work with the Department of Social Services to determine the feasibility of pursuing an Independence Plus waiver that may allow the State to claim federal reimbursement for a portion of the expenditures for caregiver services provided by legally responsible family members to participants in the In-Home Supportive Services program.

➲ ***Health Services' Action: Pending.***

Health Services says that due to the state budget crisis and lack of available staff to develop the new Independence Plus waiver, it has suspended efforts in this area. When it obtains additional resources to work on the waiver, it says it will resume working with the Department of Social Services to obtain federal approval.

Finding #3: California is not obtaining the maximum funding available from some federal grants, but to do so generally would require more state spending.

The State has lost some federal dollars because departments were unable to obtain the matching state dollars required by federal programs. For example, a Health Services program to recognize high-quality skilled nursing facilities would have received more federal grant money had state matching funds been available. For fiscal years 2001–02 and 2002–03, the federal government agreed to provide as much as $16 million for the program. In fact, however, Health Services received only $4 million in state funding for this program during fiscal year 2001–02, and it received no state funding for the program in fiscal year 2002–03 because of cuts in General Fund spending. Consequently, the State received $12 million less in federal funding than it would have if it had spent the originally planned state match.

In addition, a reduction in state funding for several transportation-related funds may lead to the loss of federal funding for local projects. For example, the Los Angeles County Metropolitan Transportation Authority reported that if it could not replace traffic fund contributions, it risked losing $490 million in federal funds for one project. In April 2003, it requested that this project replace other projects already earmarked for funding by another state transportation fund in order to secure the federal funding. The use of state matching dollars to maximize federal funds must, however, be balanced against the State's other priorities.

We recommended that the Legislature may wish to ask departments to provide information related to the impact of federal program funding when it considers cuts in General Fund appropriations.

Legislative Action: Unknown.

Finding #4: The State has lost and may continue to lose some federal funds because of an inability to obligate funds, federal sanctions, and budget constraints.

Over the last three fiscal years, agencies sometimes lost federal funds by failing to obligate funds within the grants' period of availability. In addition, noncompliance with program guidelines in four instances resulted in funding losses of more than $758 million, mostly related to the lack of a statewide child support automation system. Finally, the statewide hiring freeze sometimes keeps agencies from spending available federal funding on grants staff, and a pending budget cut of 10 percent in personnel costs may further limit spending of federal funds.

Period of Availability

The most significant loss of federal funds resulting from a failure to obligate funds within a grant's period of availability relates to the Children's Insurance program grant, which is administered by the Managed Risk Medical Insurance Board (board). According to the board, over the last three years the State has forgone as much as $1.45 billion in available federal funding because of a slow start-up and limited state matching funds. As a state initiating a new program, California's need to enroll clients led to a slow start-up of the Children's Insurance program and a resulting loss of federal funds, which primarily match a state's spending on insurance coverage for enrollees. According to a report by San Diego State University, administrative start-up costs made up a high proportion of total costs for states with new Children's Insurance programs, but the federal Children's Insurance program limits federal funding for these costs to 10 percent of total program costs. Thus, states with new programs had to bear most of the costs for outreach and other administrative expenditures during this phase.

California has not had enough qualified program expenditures to use its total annual allocations each year, but expenditures have been rising steadily. According to estimates by the board, reimbursable program expenditures will approximate its annual

allocations in the next few years. Thus, the board estimates that unspent grant funds that carry over from year to year, though still large, will decline, and reversions to the federal government will stop after October 2003.

Program Noncompliance

Noncompliance with program guidelines in four instances resulted in funding losses of more than $758 million, mostly related to the lack of a statewide child support automation system. Since 1999, California has paid federal penalties for failing to implement a statewide child support automation system. Through July 2003, the total amount of federal penalties paid by the State amounted to nearly $562 million. The estimated penalty payment for fiscal year 2003–04 is $207 million.

As a step toward eliminating the penalties, the Legislature enacted Chapter 479, Statutes of 1999, providing guidelines for procuring, developing, implementing, and maintaining a single, statewide system to support all 58 counties and comply with all federal certification requirements. In June 2003, the Department of Child Support Services and the Franchise Tax Board, which is managing the project, submitted a proposal to the Legislature to enter into a contract with an information technology company to begin the first phase of project development in July 2003, with implementation in the 58 counties completed by September 2008. The total 10-year project cost is $1.3 billion, of which $801 million is for the contract. The federal government has conditionally approved the project, which is estimated to be eligible for 66 percent federal funding.

Hiring Freeze and Proposed 10 Percent Staff Reduction

In order to address the State's significant decline in revenues, Governor Gray Davis has undertaken several initiatives to reduce spending on personnel. These include a hiring freeze in effect since October 2001 and a 10 percent reduction in staffing proposed in April 2003. The hiring freeze already has had a negative effect on some federal programs, and the 10 percent reduction may affect them as well. After the October 2001 executive order, the Department of Finance (Finance) directed agencies, departments, and other state entities to enforce the hiring freeze. It also established a process for exempting some positions. The process includes explaining why a particular

position should be exempted and what the effect of not granting an exemption would be. Departments and their oversight agencies must approve the exemptions and then forward them to Finance for approval.

In response to our audit survey, staff at two departments said the hiring freeze and an inability to obtain exemptions had affected their federal programs negatively. In September 2002, the U.S. Centers for Disease Control and Prevention (CDC) wrote to Health Services noting vacant positions within the State's National Cancer Prevention and Control program and difficulties in filling vacancies due to the state-imposed hiring freeze as a major weakness. In a December 2002 letter of response to the CDC, Health Services indicated that it had filled some vacant positions, and in March 2003 Health Services sent exception requests for five federally funded positions to Finance, four of which Finance denied. As of June 2003, Health Services said that the CDC planned to reduce its grant for the 12 months ending June 30, 2004, to $8.4 million from the $10.6 million awarded for the nine months ending June 30, 2003. Health Services said an important element in the CDC's reduction was Health Services' inability to fill vacant federally funded positions.

Similarly, the U.S. Department of Agriculture (USDA) informed the Department of Education's (Education) Nutrition Services Division in September 2002 that through a management evaluation it had identified corrective actions in several areas where a lack or shortage of staff contributed to findings. It was concerned about staffing shortages in a unit responsible for conducting reviews and providing technical assistance to sponsoring institutions participating in the child nutrition programs. It warned that the USDA may withhold some or all of the federal funds allocated to Education if it determines that Education is seriously deficient in the administration of any program for which state administrative funds are provided. In May 2003, the State Superintendent of Public Instruction wrote to the Governor's Office asking for approval of a blanket freeze exemption allowing Education to fill all division vacancies, reestablish 12 division positions eliminated during the fiscal year 2002–03 reduction of positions, and exempt the division from a proposed 10 percent reduction in staff.

We recommended that Finance ensure that it considers the loss of federal funding before implementing personnel reductions related to departments' 10 percent reduction plans.

Finance Action: Partial corrective action taken.

Control Section 4.10 of the 2003 Budget Act, approved by Governor Gray Davis in August 2003, requires the Director of Finance to reduce departments' budgets by almost $1.1 billion and abolish 16,000 positions. Finance states that it specifically omitted any federal funds from its August 2003 notice to the Legislature identifying the appropriations to be reduced in accordance with this section. It did this so that departments would not be required to reduce federal fund appropriations without full consideration of the effects.

FRANCHISE TAX BOARD

Its Performance Measures Are Insufficient to Justify Requests for New Audit or Collection Program Staff

REPORT NUMBER 2002-124, MAY 2003

Audit Highlights . . .

Our review of the Franchise Tax Board's (board) audit and collection activities revealed the following:

- ☑ *The board does not always describe the differing cost components of its various performance measures, potentially leading to confusion about program results.*
- ☑ *Between fiscal years 1998–99 and 2001–02, recently acquired audit staff returned $2.71 in assessments for each $1 of cost.*
- ☑ *Because of limitations in board data, we could not isolate the return on 175 new collection program positions.*
- ☑ *The board's process for assessing the incremental benefit of recently acquired audit and collection program positions is flawed.*
- ☑ *The board allows some collection program positions to remain unfilled in order to pay for other expenses.*

Franchise Tax Board Response from State and Consumer Services Agency as of November 2003

A primary revenue-generating agency for the State, the Franchise Tax Board (board) processes individual and corporation tax returns, audits certain tax returns for errors, and collects delinquent taxes. Between fiscal years 1990–91 and 2001–02, the board provided an average of $31 billion in annual tax revenues to the State, over 60 percent of the State's General Fund. Although many taxes are self-assessed by individuals and companies, the board's audit program reviews the accuracy of tax returns, assessing additional taxes when appropriate. In turn, the collection program pursues delinquent taxpayers identified through the board's various assessment activities.

The Joint Legislative Audit Committee requested that we review the board's audit and collection programs, identifying recently acquired audit and collection program positions, assessing the board's calculation of the costs and benefits of these positions, and determining whether the board uses these positions as the Legislature intended. We were also asked to review the board's methodology for calculating the costs and benefits of its audit and collection programs. Finally, we were asked to determine whether a point of diminishing returns exists where additional audit and collection program positions do not generate a $1 to $5 cost-benefit ratio (CBR) and, if so, to determine the board's actions to shift those positions to other activities. We found that:

Finding #1: The board uses a variety of performance measures and does not always describe their differences in public documents.

The board uses a variety of measurements to gauge audit and collection program performance and to assign workloads to staff. Most of these measurements take into account some of the costs and related benefits for program activities, but the various measurements may include differing calculations of costs, which the board does not always fully describe in public documents. As a result, misunderstandings of the board's performance may arise. Ideally, a performance measure should compare all the benefits of a program with all the costs of producing them. However, when the board's budget documents project a return of at least $5 in benefits, whether assessments or revenues, for each $1 of cost for new positions, the projected return does not reflect allocated costs for departmental overhead, such as rent and utilities, and the understated costs are not disclosed. In contrast, the historical measures reported in the board's annual operations reports are calculated using full costs.

The board's performance measures for its audit and collection programs also suffer from a partial overlap in claimed benefits, another potential source of confusion about returns on costs. After 120 days, tax assessments the audit program claims as benefits become the collection program's accounts receivable, which, if collected, are also counted as benefits of the collection program.

To more completely and clearly reveal its programs' costs and benefits, the board should consider using the complete measurement of the audit program's performance that we have described in our report. This measurement compares all the benefits—the total revenues that result over time from the auditors' assessments of additional taxes—with the total costs to produce them, including the costs of collection. If it determines that its current information system cannot produce the data necessary for such a measurement, the board should consider the needs of a complete measurement when it upgrades or changes its current information system.

If the board decides not to use the complete measurement and continues to use separate performance measurements for the audit and collection programs, in budget change documents and other reports given to external decision makers, it should:

- Explicitly disclose the elements not included in the cost components of various performance measures used to assess the audit and collection programs and the effect of their absence.

- Disclose the overlap in benefits claimed by its audit and collection programs.

Board Action: Partial corrective action taken.

The board reports that it has developed and deployed an enterprise Activity Based Costing (ABC) tool, which provides information on the costs to perform various processes and business activities. The ABC model includes both direct and indirect processes and activities, which contribute toward the board's programs, including programs that provide revenue to the state. The ABC model enables the board to calculate the "cost" element of the CBR, but additional work is required to link the cost of the work to the revenue generated.

The board reports that its Activity Based Revenue (ABR) effort will link the cost of work to the revenue generated by adding "revenue streams" as work products. By adding the revenue stream costs to ABC, the board will be able to more completely measure program performance—that is, total cost and total benefit for programs such as audit and filing enforcement.

The board states that its ABR effort will initially use existing fiscal year 2002–03 cost and revenue stream data, and will produce test performance measures by Spring 2004. The board will evaluate the test performance measures and make recommendations for improvements for fiscal year 2003–04 data collection. Additionally, through its ABR effort, the board is evaluating the ability of its current information systems to produce the data required for a complete measurement, and will make recommendations for future consideration. The board states that the test performance measures and recommendations will be complete by June 2004.

Finally, the board reports that it has begun to provide clarification to performance measures reported to external decision makers. It states that recent documents provided to the Department of Finance (Finance) and the Legislative Analyst's Office (LAO) have both footnoted the measurement type and clarified its discount status. The board plans to continue this practice in future communications.

Finding #2: Prospective cost-benefit ratios for individual audit types do not reflect historical performance.

The board's historical performance measure of returns on its audit program includes the full effect of indirect costs, including departmental overhead, but the prospective CBRs for individual audit types do not. Thus, when full departmental overhead costs are taken into account, certain prospective CBRs drop below the anticipated return of $5 in assessments generated for every $1 of cost.

When we deflated the board's projected returns by actual departmental overhead costs, we found that had the board included full departmental overhead costs, the total actual return in assessments would closely resemble the board's projections. However, when we examined individual audit types, the variance was much greater, and the workplan projections failed to mirror historical returns. For example, the average assessment per $1 invested in personal income tax desk audits over the period was $3.87, whereas the board estimated that they would return $6.36. Even after deflating the workplan projections by departmental overhead costs, actual assessments per dollar of cost were still $1.75 less than originally projected.

The board believes that these differences generally arise from adjustments the audit program makes to historical data ultimately reported in operations reports. According to the board, the adjustments are made to correct misallocated charges and miscoded revenue and to better match costs to benefits. If the audit program corrects errors in the financial reporting system when it recalculates the basis for projections, we would expect that the board would use the corrected data in the operations reports, which it publishes after it prepares the workplans.

If the board believes that information it publishes in its operations reports is not accurate, even though it is based on the board's financial accounting system, the board should:

- Ensure that its financial accounting system reports accurate information, and

- Correct data it believes to be inaccurate before it publishes the information in its operations reports.

To track the accuracy over time of its calculations of the prospective CBRs for individual audit workload types, the board should compare these prospective CBRs against actual returns annually. The board should make the results available to Finance and the LAO and should also include them in the board's annual report to the Legislature on the results of its audit and collection activities. If the board believes this information is confidential, it can cloak the identity of the individual audit workloads in its annual report to the Legislature. Moreover, the board should use the results of the comparison in future calculations of prospective CBRs.

Board Action: Corrective action taken.

The board states that it is reviewing its methods of gathering data used in its operations reports and is reviewing actual costs and revenue reported. According to the board, progress has been made in changing the methods of assigning support costs for many sections beginning with fiscal year 2003–04. The board states that it is also continuing to look at the methods used to compile the operations reports.

The board further reports that it is compiling the information necessary to compare prospective CBRs against actual returns for its current workplan process and will include this information in its annual report to the Legislature. The board plans to use this information as one of several factors in its calculations of projected CBRs.

Finding #3: The board's budget change documents do not show how new audit positions have met projected results.

Although the board's current resource request format for new audit positions provides decision makers with more detail regarding audit workloads than the board typically provided prior to our 1999 report titled *Franchise Tax Board: Its Revenue From Audits Has Increased, but the Increase Did Not Result From Additional Time Spent Performing Audits,* its current format is still insufficient to demonstrate both the workload types to which the board intends to assign new staff and the historical return on those workloads. In addition, historical actual returns on the specific workloads are not measured against the projections used to justify the staff increases.

While the board's resource request format does include many of the features we previously recommended, it does not detail historical and projected hours and assessments by audit type as

we had suggested. Rather, the board summarizes all desk, field, and Internal Revenue Service follow-up audit activity into a single category, which obscures the very different returns on each of the personal income tax and corporation tax audit types. Without this information, decision makers are left without an accurate tool against which to measure whether the board's staffing increases return their projected assessments.

To provide useful information to decision makers when requesting additional audit positions, the board should use a format, shown in our 2003 report, that details the types of activities new auditors will perform as well as the projected assessments and historical assessments resulting from these activities. Additionally, the board should revise its supporting audit workplan to include the actual returns of each of the specific workload types for the most recently completed fiscal year.

Board Action: Pending.

The board states that before making any changes to its resource request format and supporting audit workplan it must first discuss them with the users of these documents. The board reports that due to the recent budget situation and the change in administration, discussions with the users of these reports have been delayed. According to the board, its budget director is scheduled to meet with Finance in November 2003 to discuss our suggested changes to these documents.

Finding #4: The incremental benefit of new audit positions was originally negative but has increased recently and measuring the incremental benefit of additional collection program staff proves elusive.

Although sufficiently demonstrating the overall cost-effectiveness of its audit and collection programs, the board's process for assessing the incremental benefit of recently acquired audit and collection program positions is flawed. The board uses an inadequate methodology to determine whether increases in audit assessments or collection program revenues resulted from additional positions. Rather than using an incremental approach to isolate assessment or revenue pools likely to have been affected by additional audit or collection program positions, the board compares its total projected audit assessments against its total actual audit assessments and its total projected collection program revenue against its total actual collection program revenue.

To determine the incremental benefit of the 340 net new audit positions between fiscal years 1992–93 and 2001–02, we isolated their budgeted costs and the actual assessments associated with the audits to which the board would have likely assigned the new staff. We found that the new audit positions generated average assessments of only $0.79 for every $1 of cost. It is important to note that the return on the additional positions shows improvement over more recent fiscal years. Between fiscal years 1998–99 and 2001–02, the new positions produced average assessments of $2.71 for every $1 of cost. Changes in the economy probably affected the return on these audit positions, but a significant cause of the low return is that despite having additional staff, the board did not increase the number of hours staff spent performing audits. The collection program received 175 positions between fiscal years 1998–99 and 2001–02, promising increased revenue of $179 million over that period. However, because of limitations in board data, we could not determine the return on the collection program positions.

See the recommendation under finding #3 above for addressing the measurement of the effectiveness of additional audit positions. To better measure the effectiveness of its additional collection positions, the board should develop a methodology for determining the incremental return of new collection program positions received in any given year. This type of analysis should isolate changes over a base year in revenue pools that are affected by the new positions and compare the resulting revenue against all costs resulting from the new positions.

Board Action: Partial corrective action taken.

The board reports that it is well on its way towards completing the design of a more refined methodology for measuring the effectiveness of manual collection efforts. The board states that it has established a consensus across the collection program as to the definition of "proactive," "reactive," and "automated" collection activities. The board reports that it has also created a conceptual framework for measuring inputs in terms of time expended by direct collection and support staff and matching the results in terms of dollars collected. This new framework will allow the establishment of a base year and comparison of results from year to year. The board reports that it has populated this model, run preliminary tests, and is currently evaluating the

results of those tests. Although the board plans to implement the new methodology in January 2004, it concedes that this target date may slip partially because of budget cuts.

Finding #5: The board's justification for new collection program positions does not reflect its current process for assigning work.

Unlike the audit program, which both justifies new positions and assigns work based on a workplan process that prioritizes work according to a CBR, the collection program currently uses a similar workplan process only to justify its increases in collection program positions. In actually assigning work, the board relies on the recently implemented Accounts Receivable Collection System (ARCS) to rank accounts according to various risk and yield factors that predict the likelihood of collection as well as the ultimate amount the system expects to collect. According to the director of the board's special programs bureau, now that the collection program has nearly two years of collecting experience using ARCS, analysis is under way to use data from the system to justify future staffing needs.

To more accurately represent how it actually allocates resources, the collection program should continue to develop a methodology based on ARCS for justifying future collection program positions. The revised process should include all relevant costs, including an allocation for departmental overhead, in addition to the ARCS' risk and yield factors. The estimated expenditures and projected revenues related to each new staffing request should be easy to compare against actual results.

Board Action: Partial corrective action taken.

The board reports that the workload tracking and revenue assignment methodology discussed above will complement the process used to project potential revenue from new collection positions that may be added in the future. The board expects to have this new reporting methodology in place by January 2004.

Finding #6: The board leaves some approved collection program positions unfilled.

The board is not using all of its funding for collection program salaries to actually fill authorized positions, but is instead using some funding for other costs. Periodically, the board rewards employees for meritorious performance through pay increases, or merit salary adjustments (MSA), above the initial salary funding for their positions. Before fiscal year 1999–2000, the board received budget augmentations to fund its MSAs, but beginning in fiscal year 1999–2000, the board's MSA funding ended. The difference between the total hours collection program staff worked and the total budgeted hours for the collection program increased by 5 percent shortly after the board lost its separate funding for MSAs.

Since the loss of separate MSA funding, the board has required each branch to achieve savings to pay for the branch employees' MSAs, allowing them to realize the savings from unfilled positions. The board believes state departments must leave positions vacant or they will overspend their salaries and wage budgets. However, Government Code Section 12439 requires that positions that are continuously vacant for six months be eliminated and Finance recently began eliminating those positions in state departments.

For the board to be consistent with the intent of budget control language and Finance, it should not, as a long-term strategy, leave collection program positions unfilled beyond the normal time it takes to fill a position.

Board Action: Corrective action taken.

The board reports that Finance removed all vacancies in existence on June 30, 2003, but has since returned some of the positions. According to the board, a small number of vacancies currently exist, but it states that virtually every vacancy in the collection program will be filled by the end of December 2003. The board also states that it will fill any future vacancies at the earliest opportunity. Finally, the board states that any future funding requests for additional positions will be based on a realistic estimate of appointment dates for the new employees.

DISABLED VETERAN BUSINESS ENTERPRISE PROGRAM

Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success

Audit Highlights . . .

Our review of the Disabled Veteran Business Enterprise (DVBE) program found that:

- ☑ *Many awarding departments do not report their DVBE participation levels; of those that do report, most do not meet the 3 percent participation goal.*
- ☑ *The reasonableness of the 3 percent goal itself is not clear.*
- ☑ *Outreach to potential DVBEs should be more aggressive.*

Other factors that contribute to the State's failure to meet the DVBE goal are:

- ☑ *The program's overly flexible legal structure and limited clarifying regulations.*
- ☑ *The frequency with which certain departments exercise their discretion to exempt contracts from DVBE participation.*
- ☑ *Lack of effective evaluation of bidders' good-faith efforts and monitoring of contractors' compliance with contract DVBE requirements.*

REPORT NUMBER 2001-127, JULY 2002

Audit responses as of July 2003 and October 2003[1]

The Joint Legislative Audit Committee requested that we determine the extent to which departments that award contracts (awarding departments) are meeting the 3 percent Disabled Veteran Business Enterprise Program (DVBE) participation goal and to identify statutory and procedural mechanisms that could assist in overcoming any barriers to fulfilling this goal. We found that many awarding departments do not report DVBE participation as required under law, and even fewer departments actually meet the goal. Specifically, we found:

Finding #1: Awarding departments' DVBE participation statistics are not always accurate, and the methodologies they employ are at times flawed.

State law requires each awarding department to report to the governor, Legislature, the Department of General Services (General Services), and the Department of Veterans Affairs (Veterans Affairs) by January 1 each year on the level of participation by DVBEs in state contracting. General Services then issues a summary report.

Our own review showed that some awarding departments did not report DVBE statistics and others could not always provide supporting documentation for the DVBE statistics they reported. For example, for fiscal year 2000–01, the Department

[1] Business, Transportation and Housing; State and Consumer Services; and Youth and Adult Correctional agencies and Departments of General Services, Transportation, and Veterans Affairs responses as of July 2003. Departments of Fish and Game and Health Services and Health and Human Services Agency responses as of October 2003.

of Fish and Game (Fish and Game) reported $12.1 million in DVBE participation but could identify only $431,000 in specific contracts, or less than 3.6 percent of the total. In addition, the Department of Health Services (Health Services) could not provide any summarized documentation for the numbers it reported. Health Services asserted that it had documentation in individual contract files to support its figures, but indicated it would be too time intensive to tally the information for our review.

Additional problems with the accuracy of DVBE participation information exist. The reporting methodology General Services established is contrary to statutory requirements. According to statute, the 3 percent DVBE participation goal applies to the overall dollar amount expended each year by the awarding department. However, under current reporting regulations issued by General Services, awarding departments must report the amount winning bidders "claim" they will pay to DVBEs under the contract. In its clarifying instructions, General Services has asked awarding departments to report the amounts "awarded" in contracts, rather than amounts actually paid to DVBEs.

To ensure DVBE statistics are accurate and meaningful, we recommended General Services require awarding departments to report actual participation and maintain appropriate documentation of statistics, continue its periodic audits of these figures for accuracy, and, if the audits reveal a pattern of inconsistencies or inaccuracies, address the causes in its reporting instructions.

General Services' Action: Partial corrective action taken.

General Services has interpreted the statutes governing DVBE reporting to provide participation statistics to be reported based on the value of contracts awarded instead of dollars actually expended. According to General Services, this is the same methodology used in the small business participation report (California Government Code, Section 14840). General Services believes it is important to use consistent reporting standards to allow for program comparisons. Since its six-month response, based on the concerns raised by our office, General Services has revisited the issue and concluded that its own interpretation of the DVBE reporting requirements is reasonable and appropriate. We disagree with General Services' interpretation of the DVBE reporting requirements. As we state on page 18 of the audit report, departmental reporting of actual payments [to DVBEs] provides more useful information because it focuses on the realized benefit to DVBEs.

As to the issue of requiring departments to maintain documentation of participation statistics, to reemphasize this administrative control procedure, General Services indicates it has added an instruction to the new participation report form that addresses the necessity of maintaining supporting documentation. Departments used this new form in reporting fiscal year 2001–02 cumulative participation statistics. General Services is also continuing to include the audit of the DVBE reporting process within its comprehensive external compliance audit program performed of other state agencies. It indicates it uses the results of these audits to identify areas for possible improvement within the reporting process.

Finding #2: Not all state agencies have finalized and implemented their plans to monitor their departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, require a DVBE improvement plan.

In June 2001, the governor issued executive order D-43-01, which requires all state agency secretaries to review the DVBE participation levels achieved by the awarding departments within their agencies. Further, the executive order requires each secretary to require awarding departments to develop an improvement plan if the 3 percent goal is not achieved or the data is not reported. Three of five state agencies responding to our survey indicated that they were still developing procedures to monitor the DVBE participation levels of their subordinate awarding departments.

We recommended those state agencies that have not already done so should finalize and implement their plans to monitor awarding departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, monitor their efforts to improve DVBE participation.

Agency Action: Partial corrective action taken.

On June 28, 2002, the governor directed that all state departments and agencies submit monthly reports to the State and Consumer Services Agency regarding DVBE participation. Based on the reporting forms developed by the State and Consumer Services Agency, state departments and agencies are required to report total contracting dollars,

dollars paid to DVBEs, and DVBE participation percentages. In addition, departments that have not met the 3 percent DVBE participation goal are required to explain why.

Each of the following state agencies indicates the development of plans to monitor awarding departments' reporting of DVBE statistics: State and Consumer Services Agency; Business, Transportation and Housing Agency; Health and Human Services Agency; and the Youth and Adult Correctional Agency. The Resources Agency did not provide a one-year update on its efforts to implement this recommendation. Some agencies reported increases in DVBE participation during the fiscal year 2001–02. In particular, the State and Consumer Services Agency reported a DVBE participation rate of 3.3 percent in 2002, which is an increase from 1.5 percent in the prior year. Further, the Business, Transportation and Housing Agency similarly reported an increase in DVBE participation, indicating 3.7 percent participation during the fiscal year 2001–02.

Finding #3: The State does not know how many DVBEs can be certified and the extent to which they can provide needed goods and services to the State. As a result, the reasonableness of the 3 percent goal is uncertain.

Even though the law establishes a 3 percent participation goal for every awarding department, our review did not find sufficient evidence to support the assumption that this is an equitable share of contracts for DVBEs. When the DVBE legislation was being drafted in 1989, several awarding departments opposed the bill on the grounds that the 3 percent goal was unrealistic.

The awarding departments' concern about enough DVBEs to justify the 3 percent goal seems to have been valid. As of May 2002, General Services had only 797 DVBEs certified and available for contracting. The services these DVBEs offered and their geographical distribution did not always match the State's needs. All five agencies responding to our survey and many awarding departments' improvement plans identified a limited pool of DVBEs as one of the impediments to meeting the 3 percent DVBE participation goal.

To determine if the 3 percent DVBE goal is reasonable, the Legislature may wish to consider requiring either General Services or Veterans Affairs to commission a study on the

potential number of DVBE-eligible firms in the State, the services they provide, and their geographic distribution, and compare this information to the State's contracting needs.

Based on the results of this study, the Legislature may wish to consider doing the following:

- Modify the current DVBE participation goal.
- Allow General Services to negotiate department-specific goals based on individual contracting needs and the ability of the current or potential DVBE pool to satisfy those needs.

Legislative Action: None.

We have found no indication that any study on DVBE-eligible firms has been commissioned. Further, the statutory requirement for the DVBE participation rate remains at 3 percent, while the reasonableness of this goal remains unclear.

Veterans Affairs' Action: None.

According to Veterans Affairs' September 2002 response to this recommendation, it appears that the department was intending to commission a study on the number of potentially DVBE-eligible firms in the State. However, the department's July 2003 update does not specifically address this recommendation.

Finding #4: General Services is not sufficiently aggressive or focused in its outreach and promotional efforts for the DVBE program.

As the administering agency for the DVBE program, General Services has been responsible for certifying eligible businesses as DVBEs and conducting promotional and outreach efforts to increase the number of certified DVBE firms.

It is unclear to what extent General Services' outreach activities target disabled veterans' groups. General Services was also unable to readily quantify its outreach activities. The information it ultimately provided was based on old personal calendars and planners. We also could not evaluate the effectiveness of these outreach activities since General Services only selectively monitors the results.

To ensure the DVBE program is promoted to the fullest extent possible, we recommended General Services aggressively explore outreach opportunities with the U.S. Department of Veterans Affairs and organizations such as the American Legion, Disabled American Veterans, and Veterans of Foreign Wars. In particular, General Services should cultivate a clear working relationship with county veteran service officers. It should also maintain complete records of its outreach and set up a system to track effectiveness. For example, General Services could consistently survey newly certified DVBEs to determine how they heard about the program and what convinced them to apply for certification. Finally, General Services and Veterans Affairs should continue to work to develop their joint plan for improving the DVBE program, finalizing and implementing it as soon as possible.

General Services' and Veterans Affairs' Action: Partial corrective action taken.

On June 28, 2002, the governor directed the implementation of a more intensive DVBE outreach effort, with the staff dedicated to that effort moved from General Services to Veterans Affairs. According to General Services, on August 1, 2002, the two DGS staff members performing the outreach function physically transferred to Veterans Affairs.

According to the July 2003 response from Veterans Affairs, it has completed the CDVA Disabled Veterans Business Enterprise Outreach Program Plan, which became effective April 1, 2003. The plan indicates that Veterans Affairs will introduce General Services "outreach team members" to veteran organizations' leadership and local county veteran services officers. However, Veterans Affairs also indicated that in May 2003, the two employees working on DVBE outreach, formerly from General Services, returned to that department. The plan also indicates that Veterans Affairs will establish working relationships with veteran service representatives and local county veteran service organizations.

Finding #5: Some awarding departments exempt a significant number of contracts, potentially limiting their ability to maximize DVBE participation rates.

Under statute, the DVBE participation goal applies to an awarding departments' overall expenditures in a given year. Therefore, awarding departments have the discretion to apply DVBE participation requirements on a contract-by-contract basis.

The frequency with which certain awarding departments exempt contracts from DVBE requirements is significant. Further, some of these awarding departments are not tracking the value of the contracts they exempt or the required compensating increase in participation goals for their remaining non-exempt contracts. For fiscal year 2000–01, two of the five awarding departments we reviewed, Health Services and Caltrans, did not compensate for these exemptions with increased participation on other contracts, and subsequently reported they did not meet the participation goal. According to our calculations, Health Services exempted 48 percent of DVBE-eligible contract dollars it reported in fiscal year 2000–01, which means it would have had to average almost 6 percent on all remaining eligible contracts to meet the goal. Similarly, General Services' procurement division estimated that it exempted over 50 percent of its contracts during fiscal year 2000–01.

Awarding departments offer varying reasons for their exemption decisions. Some departments we reviewed exempt all contracts with certain characteristics, and the reasonableness of these blanket decisions may not be clear. For example, at least one unit within four of the five departments we reviewed has indicated it exempts all contracts it believes do not offer a subcontracting opportunity for DVBEs. However, this practice may significantly reduce a department's chances for obtaining more DVBE participation.

To maximize DVBE participation, we recommended awarding departments attempt to use DVBEs as prime contractors instead of viewing them only as subcontractors. Further, the awarding departments should periodically examine the basis for their assumptions behind blanket exemptions for whole categories of contracts to ensure the exemptions are justified.

General Services', Caltrans', Health Services', and Fish and Game's Action: Partial corrective action taken.

General Services indicates it has policies and practices that actively encourage the use of DVBEs as prime contractors. Further, General Services has asserted that its chief deputy director stressed to General Services staff that all contracts include DVBE participation unless specifically exempted. Caltrans indicates that its DVBE exemption requests are researched to verify that no certified DVBEs are available in the particular geographic area specified to perform the work. Caltrans also indicates that it mails DVBE solicitation

materials to contractors who are on a special list of DVBEs and who provide services in the geographical area. Health Services similarly reported that it now reviews each DVBE exemption request by requiring its programs to explain why DVBE participation is not viable or possible. Health Services also requires that General Services' Web site be verified to ensure no DVBEs are available to perform likely subcontract services in the service location. Fish and Game asserts it does not have a blanket exemption by category type. However, it indicates that it does exempt contracts under $10,000 from DVBE participation requirements. Fish and Game has determined that requiring bidders to undergo a good-faith effort to find and use a DVBE under these circumstances is not cost-effective. Fish and Game also indicates that if the lowest bidder on a contract is a DVBE, it awards the contract to the DVBE acting as a prime contractor.

Finding #6: Awarding departments do not consistently scrutinize and evaluate good-faith effort documentation or ensure that DVBEs are actually being used as called for in contracts.

The effectiveness of the implementation of the good-faith effort may be diminished by the lack of consistent or meaningful standards for awarding departments to follow when evaluating bidders' documentation of such efforts. Although statute requires General Services to adopt standards, it has not issued much direction to awarding departments on how to evaluate a bidder's good-faith effort. The State Contracting Manual offers appropriate suggestions for procedures in assessing good-faith effort, but the suggestions are not binding. There is also no clear requirement in statute requiring awarding departments to monitor actual DVBE participation to ensure the contractor is complying with the contract's DVBE requirements.

A common result of this lack of direction is the cursory evaluation of a bidder's good-faith effort documentation and inconsistent monitoring of actual DVBE usage. For example, Health Services does not instruct staff to independently verify bidders' statements that they solicited DVBEs to participate as subcontractors. Before February 2002, Health Services also lacked policy to monitor actual DVBE participation. Caltrans also does not follow up to ensure the DVBEs that the bidder claimed to have solicited were actually contacted. Although

Caltrans' procurement unit did have a policy to monitor actual DVBE participation to ensure contract compliance, we saw no monitoring consistent with this policy in a sample of their contract files.

To ensure that prime contractors make a genuine good-faith effort to find a DVBE, we recommended the Legislature consider requiring awarding departments to follow General Services' policies. General Services should issue regulations on what documentation the awarding departments should require and how they should evaluate that documentation. These standards should include steps that ensure the documentation submitted is accurate. Similarly, General Services should issue regulations on what steps departments should take to ensure contractors meet DVBE program requirements. These steps might include requiring awarding departments to monitor vendor invoices that detail DVBE participation or requiring the vendor and DVBE to submit a joint DVBE utilization report.

Legislative Action: None.

We found no indication that the Legislature has required awarding departments to follow General Services' policies regarding the evaluation of bidders' good-faith effort documentation.

General Services' Action: Partial corrective action taken.

Effective April 1, 2003, the procurement division of General Services revised its solicitation instructions and forms to require bidders to provide additional information and documentation on their compliance with DVBE program requirements. These new bidder instructions are available on General Services' Web site and are available for use by other state agencies. Further, General Services states that it has begun the process of reviewing DVBE program regulations to identify areas of improvement.

Finding #7: The efficiency and effectiveness of the DVBE program could be improved with legislation aimed at providing incentives for DVBE participation and penalties for bidders who do not comply with program requirements.

Legislation establishing the DVBE program does not have adequate provisions to ensure compliance with program goals.

To increase the efficiency and effectiveness of the DVBE program, we recommended the Legislature consider doing the following:

- Replace the current good-faith effort step requiring bidders to contact the federal government with a step directing bidders to contact General Services for a list of certified DVBEs.
- Enact a contracting preference for DVBEs similar to the one for the small business program—that is, allow an artificial downward adjustment to the bids from contractors that plan to use a DVBE to make the bids more competitive.
- Require awarding departments to go through their own good-faith effort in seeking DVBE contractors.
- Provide awarding departments with the authority to withhold a portion of the payments due to contractors when they fail to use DVBEs to the extent specified in their contracts.

➲ ***Legislative Action: None.***

We found no indication that the Legislature has passed legislation addressing the recommendations presented above.

DEPARTMENT OF GENERAL SERVICES

Certain Units Can Do More to Ensure That Client Fees Are Reasonable and Fair

REPORT NUMBER 2002-108, DECEMBER 2002

Department of General Services' response as of December 2003

Audit Highlights . . .

We found that certain units within the Department of General Services (General Services) often missed their estimates of project fees charged to client departments by more than 20 percent. These units, which are within General Services' Real Estate Services and Telecommunications divisions, could improve the accuracy of their estimates by more consistently employing the following best practices:

- ☑ *Document how estimates are calculated.*
- ☑ *Ensure the review and approval of estimates.*
- ☑ *Use multiple estimating approaches—along with historical data—to validate estimates.*
- ☑ *Evaluate estimates on completed projects.*

Further, we found that certain units could more accurately prepare and report cost data that General Services' management uses to decide on hourly rates. Finally, the Office of Public Safety Radio Services needs to improve its billing practices.

The Joint Legislative Audit Committee (audit committee) requested the audit after hearing concerns from the Legislative Analyst's Office (LAO) regarding the appropriateness of the Department of General Services' (General Services) capital outlay project management fees. We evaluated General Services' estimates of fees it charges departments for capital outlay and telecommunications projects—which generated three-quarters of General Services' project management fees during fiscal year 2001–02—and concluded that improvements can be made. Specifically, we found:

Finding #1: Some units do not always follow best practices or their own procedures when estimating project costs and fees.

Although units within General Services' Real Estate Services Division (Real Estate Services) and Office of Public Safety Radio Services (Radio Services) do well with certain aspects of estimating costs and fees for capital outlay and radio equipment installation projects, they do not always follow the best practices we identified or their own procedures. Specifically, staff were unable to provide us with documentation to demonstrate how the estimators derived the estimated cost for all line items for eight of the 10 projects we reviewed. In addition, Radio Services could not always demonstrate that its project estimates received either client or supervisory approval. The lack of client approval for two projects may lead to Radio Services absorbing $93,000 of the projects' costs. Moreover, these units are not consistently using multiple cost estimating approaches—along with historical data—when preparing estimates and are not conducting end-of-project reviews to evaluate the success of their estimates. We also found that Radio Services had not compared actual results to the estimates it generated using an estimating tool. As a result of these deficiencies, General Services cannot ensure that fees charged to client departments for these services are reasonable and fair. Further, the significant variances we found in project

estimates and line item estimates—many exceeding actual costs by more than 20 percent—further support the need to follow best practices when estimating fees.

To ensure that its estimates of project costs and fees are accurate and defensible and to improve the reliability of its process for estimating project costs, we recommended that General Services employ the following best practices:

- Adopt and follow a procedure to thoroughly document assumptions used in creating project estimates.
- Document evidence of supervisory and client review and approval and, if needed, develop a process for expedited client approval when clients of Radio Services insist that projects start immediately.
- Conduct evaluations at the end of each major project.
- Develop a historical database of completed projects and use the database to provide support for future estimated project costs for all major projects.
- Use multiple cost-estimating approaches for all significant line item estimates of major projects.
- Periodically review the performance of its cost-estimating tools against actual results and update the tools when necessary.

General Services' Action: Partial corrective action taken.

General Services agrees with the elements of best practices identified in our report and is striving to implement processes that include those practices. Specifically, General Services states that both Real Estate Services and Radio Services now require staff to document assumptions used to prepare fee and project estimates, along with the supervisory approval of these estimates. However, Radio Services continues to begin work on telecommunications projects before clients approve the costs, but does require that clients put their requests to start work on projects without approved costs in writing. While Real Estate Services indicates it has taken steps to better evaluate the estimates for completion projects, Radio Services believes that it is unable to perform in-depth post-evaluations of all major telecommunications

projects until it implements a new system known as the Automated Enterprise Support and Oversight Product system. This system will integrate Radio Services' existing automated and manual systems to allow for better management of its business practices. Because Radio Services does not expect to award a contract to develop this system until January 2004, it modified existing systems to include more relevant budget and cost information for staff to use when making estimates. Finally, General Services states that as more historical cost information becomes available, both Real Estate Services and Radio Services will be able to use additional cost estimating approaches.

Finding #2: Reports used to determine client hourly rates do not always reflect actual costs and Fiscal Services does not always allocate its overhead fairly.

Although General Services' process for developing the hourly rates of staff—which are the basis of many fee estimates—appears reasonable, it can improve the accuracy of a report that management uses to decide on the hourly rates. Units that provide services—with the assistance of General Services' Office of Fiscal Services (Fiscal Services)—provide management a report to allow it to make the decisions on hourly rates. The report recommends hourly rates for each type of service and is designed to include the at-cost rate for each service, which is calculated by dividing projected costs by the projected billable hours. However, we found that Radio Services' staff made $10.2 million in arbitrary or unsupported adjustments, such as shifting costs between units when calculating its at-cost rate. In addition, Fiscal Services allocated its overhead—which amounted to $7.6 million for fiscal year 2001–02—to units based partly on the units' ability to absorb the costs rather than on actual services provided. Although some of these adjustments may be justified, staff told us that some of the adjustments were made to achieve hourly rates similar to the prior-year rates. This preliminary "leveling" process distorts the picture that management sees when making rate decisions, and may lead to setting rates inappropriate to recover actual unit costs. In addition, some adjustments cause other units within General Services to shoulder more than their fair share of costs.

To ensure that the reports General Services uses in setting hourly rates reflect the true projected cost for each unit, we recommended that it require units to include in their

cost-recovery proposals the actual, unadjusted, at-cost hourly rate and clearly document the existence of and retain support for any adjustments designed to achieve a desired or recommended hourly rate. Also, to improve its method of allocating overhead and to make the process more objective, Fiscal Services should consider using another method to allocate its overhead costs to other units, such as using an average of two or three years' actual costs per unit.

General Services' Action: Corrective action taken.

General Services stated that as a part of its annual financial plan process, its executive management team will be provided at-cost rates as well as various other rate scenarios that will impact an operating unit's ability to be financially solvent and avoid rate volatility. In addition, Radio Services now requires that staff retain all documents and data to support adjustments to hourly rate calculations. Finally, Fiscal Services has revised its method of allocating its overheard costs to other General Services' units to be based on the average actual cost of services provided to each unit from the most recent three fiscal years.

Finding #3: Radio Services can improve its methods for assessing consulting fees related to system services and can improve its billing practices.

In addition to installing and maintaining telecommunications equipment, Radio Services provides consulting services such as preparing cost studies, developing reports, attending client meetings, and common services such as Federal Communication Commission (FCC) license renewals, representing the State before the FCC, and developing equipment specifications. However, we could not determine whether the consulting fees that Radio Services charges to client departments were reasonable and fair because of weaknesses in its cost accounting system. Further, we also found that Radio Services does not review for errors in invoices before they are sent to departments but instead it relies upon departments to detect billing errors. In one instance, the lack of review resulted in an under billing of $126,000 to a department. Compounding the problem is that Radio Services' invoices generally contain insufficient detail to allow departments to detect billing errors.

To improve the reliability and accuracy of its client fees, we recommended that Radio Services improve its cost accounting system so that it can ensure billings to client departments are reasonable and fair. In addition, we recommended that Radio Services review the accuracy of all invoices and continue its efforts to provide its clients with an adequate amount of invoice detail for them to review the accuracy of charges.

Radio Services' Action: Partial corrective action taken.

Radio Services reports that it has improved the controls over how staff charges time to client departments and strengthened the procedures for reviewing client invoices. In addition, for departments that request to be billed an annual fixed amount for services, Radio Services now bases these invoices on a three-year average of past costs to provide these services. However, Radio Services believes that it cannot provide client departments additional invoice detail to review the accuracy of charges until after it implements the Automated Enterprise Support and Oversight Product system. As mentioned previously, Radio Services does not expect to award a contract to develop this system until January 2004.

STATEWIDE PROCUREMENT PRACTICES

Proposed Reforms Should Help Safeguard State Resources, but the Potential for Misuse Remains

Audit Highlights . . .

Our review of the State's procurement practices revealed the following:

- ☑ *Until the governor's May 2002 Executive Order, departments did not compare prices among California Multiple Award Schedule vendors.*
- ☑ *Inadequate oversight by the Department of General Services (General Services) contributed to the problems we identified with departments' purchasing practices.*
- ☑ *Without comparing prices, the State purchased millions in goods and services for the Web portal from vendors that played a role in defining the approach and architecture for the project.*
- ☑ *Estimated Web portal project costs given to administrative control agencies and the Legislative Analyst's Office were sometimes inaccurate.*
- ☑ *Before the Executive Order, departments frequently misused alternative procurement practices—sole-source contracts and emergency purchases.*

REPORT NUMBER 2002-112, MARCH 2003

Department of General Services and the Stephen P. Teale Data Center responses as of September 2003

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to audit the California Multiple Award Schedule (CMAS) program and the State's sole-source contracting procedures. Specifically, the audit committee asked that we review the process used by General Services when establishing the CMAS vendors list and the procedures and practices used to identify qualified contractors and consultants when using noncompetitively bid and CMAS contracts to procure goods and services. The audit committee also asked us to include in our review procurements related to the state Web portal.

Finding #1: Departments largely ignored recommended procedures for purchasing from CMAS vendors.

Our review of CMAS purchases made by nine state departments revealed that, before May 2002, when an Executive Order called for wholesale changes in the State's procurement practices, few departments took prudent steps, such as comparing prices, to ensure that they obtained the best value when acquiring goods and services from CMAS vendors. For example, largely at the request of two former officials of the Governor's Office, the Department of General Services (General Services), the Stephen P. Teale Data Center (Teale Data Center), and the Health and Human Services Data Center purchased more than $3.1 million in goods and services for the state Web portal from one CMAS vendor without comparing prices or using some other means to determine that the selected vendor provided the best value to the State. Additionally, General Services and the Teale Data Center purchased items for the Web portal totaling $690,000 that were not included in the vendors' CMAS contract.

Recent changes to the CMAS requirements have slowed but not halted departments' misuse of the CMAS program. Specifically, departments did not obtain at least three price quotes, as required, for two of the 25 CMAS purchases made after the date of the Executive Order.

In order to ensure that the State receives the best value when acquiring goods and services, we recommended that departments stress adherence to all CMAS requirements and reject requested purchases if these requirements are not met. Additionally, departments should review the appropriate CMAS contract to ensure that the requested good or service is included in the contract.

General Services' Action: Corrective action taken.

According to General Services, former Governor Gray Davis' Cabinet Secretary and Deputy Chief of Staff and the former Director of the Department of Finance jointly issued a memorandum to all departments notifying them that General Services' comprehensive training program for state contracting and procurement professionals is mandatory. The memorandum also encouraged all departments to review their procurement and contracting operations to ensure that all activities within these programs are conducted in compliance with requirements. These requirements are discussed most recently in a management memo issued by General Services on May 28, 2003, that establishes strict requirements for procuring goods and services through the use of CMAS and non-competitively bid acquisition methods.

Finding #2: The State's failure to compare prices created the appearance that some companies may have had an unfair advantage in selling Web portal components to the State.

The Web portal was developed with guidance from a group of executives from several private businesses, some of which later sold products for the project. Members of this group, called the Web Council, gave their "unanimous blessing to the portal's conceptual approach and its specific architecture." According to the minutes and agendas from Web Council meetings, representatives of several companies participating in the council made presentations to discuss their companies' products. Three of these companies ultimately sold hardware

and software components to the State for the Web portal totaling $2.5 million. These companies sold their products to the State, either directly or indirectly through resellers with CMAS contracts. The concept of obtaining guidance from industry experts is meritorious if, after obtaining the guidance, the State engages in an open, competitive procurement process. However, if obtaining advice from industry experts is followed by procurement of their goods or services without comparing prices to those offered by others, as was the case with numerous CMAS purchases for the Web portal, an appearance of unfairness is created.

In September 2002, the Teale Data Center assumed responsibility for providing management, maintenance, and support for the Web portal project. To ensure that the State's investment in the Web portal is a prudent use of taxpayer resource, it should use the competitive bidding process for purchasing goods and services for the project.

Teale Data Center Action: Corrective action taken.

Teale Data Center regularly utilizes General Services' contract registry to seek competition. Further, it is standard Teale Data Center practice to exceed the minimum number of bids required for informal bids as this practice ensures diverse vendor participation. Finally, as the existing Web portal services and maintenance contracts required renewal, Teale Data Center has competitively bid all subsequent new contracts.

Finding #3: General Services and former officials of the Governor's Office did not follow state policy governing information technology projects.

General Services—the administrator of the Web portal project—failed to obtain the necessary approvals from the former Department of Information Technology (DOIT) and the Department of Finance (Finance) before significant changes were made to the Web portal project. The changes, which increase previously approved project costs by 94 percent, were made at the direction of the former director of eGovernment. Among the changes, estimated to cost $9.2 million, were significant enhancements related to the energy crisis and terrorist threats and ongoing maintenance provided by consultants rather than state personnel, as was originally planned. General Services submitted a special project report to DOIT and Finance explaining the reasons

for the increased cost and seeking approval for the enhancements. However, the enhancements were completed four to six months before General Services submitted the report.

Additionally, General Services did not adequately coordinate and monitor Web portal purchasing and reporting activities. As a result, the special project reports submitted to DOIT, Finance, and the Legislative Analyst's Office (LAO) did not accurately account for all Web portal purchases. Specifically, at least one special project report that General Services submitted was inaccurate because it did not include more than $1.3 million in Web portal costs incurred by its Telecommunications Division and the Health and Human Services Data Center. According to the former chief of General Services' Enterprise Business Office, only costs that were under her control were reported to the individual preparing the special project reports.

Finally, it appears that responsible officials at General Services were unaware that a revised Web portal project report, which nearly doubled the estimated cost of the project, had been submitted to DOIT, Finance, and the LAO reflecting a significant increase in total project costs. According to officials at Finance, they met with former officials of the Governor's Office and representatives from General Services to discuss the proposed cost increases. The officials at Finance stated that it is not uncommon for minor modifications to be made to a special project report after it has been submitted for approval. However, we believe that changes to a project that effectively double the estimated cost of the project do not constitute minor modifications. Moreover, Finance could not provide any documentation of its analysis of the proposed project changes and resulting cost increase. Nevertheless, it approved submitting the revised estimates to the Legislature based on available information, given the high priority of the project.

To ensure that Web portal costs are properly accounted for, the Teale Data Center should monitor project expenses by recording estimated costs when contracts and purchase orders are initiated and actual costs when paid. The Teale Data Center should also submit special project reports to Finance and the LAO when required and ensure that reported costs accurately reflect actual expenditures and commitments to date. Finally, the data center should make certain that special project reports contain estimates for at least the same number of years that earlier reports cover so that reviewers can easily identify changes in the overall projected costs.

Teale Data Center Action: Corrective action taken.

The Teale Data Center's administrative processes require an internal analysis and approval of estimated costs prior to the initiation of the bidding process. If the resulting procurement activity results in costs that exceed the original estimate, approval is required before acquisition can be completed. Teale Data Center's Finance Division has developed a spreadsheet used to monitor projected versus actual expenditures. Should requests for acquisitions vary from the original plan, they are analyzed to determine the reason for the change and if it is within budget authorization prior to the expenditure being made. The spreadsheet is updated monthly and is shared with the manager of the Web portal and the assistant director of the Enterprise Division.

Furthermore, the Teale Data Center will continue to submit special project reports to the Department of Finance and the Legislative Analyst's Office, when required, which will accurately reflect all costs for the Web portal. Finally, the Teale Data Center will ensure that any future special project report and feasibility study report have consistent reporting periods.

Finding #4: The use of multiple departments to make purchases for the Web portal resulted in payments for services that were required under earlier agreements.

Several departments made Web portal purchases rather than one office coordinating and making all purchases. Consequently, no one office carefully tracked existing purchases and compared them to newly requested purchases, and the State contracted for some services even though the same services had already been required under earlier agreements. For example, General Services' Telecommunications Division issued a $173,000 purchase order to a consulting firm for project management of ongoing operations and maintenance of the Web portal. However, the terms and services of this contract duplicated some of the terms and services of another purchase order that General Services' Enterprise Business Office had previously issued to the consulting firm.

Similarly, the Health and Human Services Data Center entered into a $246,000 agreement with a consulting firm to create a plan to develop a Web portal mirror site. In reviewing the three reports that the consulting firm submitted in fulfillment of its

agreement with the Health and Human Services Data Center, we found that the content of the reports was information the consulting firm was already obligated to provide under an earlier contract with General Services.

General Services should review past payments to the consulting firm and another vendor by General Services, the Health and Human Services Data Center, and the Teale Data Center to ensure that the State has not paid for goods or services twice. If duplicate payments were made, General Services should recover them.

General Services' Action: Corrective action taken.

General Services reviewed the transactions in question and concluded that duplicate payments did not occur.

Finding #5: Recent actions by General Services and the Teale Data Center have reduced Web portal costs.

According to the most recent special project report, jointly submitted by General Services and the Teale Data Center, total estimated costs of the Web portal were nearly $6 million less than previously reported. The reduced costs were largely due to cutbacks in Web portal maintenance that included a major reduction in the number of hours for the consulting firm to maintain the portal.

In June 2002, the interim director of DOIT stated that the consulting firm's Web portal agreements were expensive and little had been done to transfer the consulting firm's expertise to state employees so that a state department could ultimately operate the portal. He recommended that General Services extend the consulting firm's contract until a competitively selected contractor became available. He also recommended reducing the size of the contract by restricting the consulting firm's role to limited maintenance and knowledge transfer functions, ultimately turning over the maintenance of the Web portal to state employees.

In January 2003, the Teale Data Center entered into a six-month contract with the same consulting firm for $350,000 in Web portal maintenance. Unlike the manner in which previous maintenance contracts had been established, however, the Teale Data Center solicited proposals from 20 different companies and six firms responded. The Teale Data Center evaluated the responses and eventually chose the consulting firm, achieving

a 39 percent average reduction in the hourly rate over previous noncompetitively bid agreements with the firm. Therefore, the Teale Data Center should continue to use the competitive bidding process for purchases of goods and services for the project.

Teale Data Center Action: Corrective action taken.

The Teale Data Center strongly supports the competitive bid process and has competitively bid all new contracts for the Web portal.

Finding #6: State departments improperly used sole-source contracts and emergency purchase orders.

Before the May 2002 Executive Order, state departments often did not adequately justify the need for sole-source contracts. Requests for sole-source contracts were often ambiguous or failed to demonstrate that the contracted good or service was the only one that could meet the State's needs. In addition, because they failed to make sufficient plans for certain purchases, departments often used sole-source contracts inappropriately. We reviewed 23 requests for sole-source contract approval submitted by various departments and found eight examples of departmental misuse of this type of exemption. General Services, however, approved all 23 requests. In four requests that General Services approved, the departments failed to provide the kind or degree of justification we expected to see. We could not determine whether the circumstances warranted a sole-source contract for one of the 23 requests because the department's justification was ambiguous. Finally, in three of the 23 sole-source requests, the departments sought the contracts because they failed to properly plan for the acquisition and, as a result, did not have time to acquire the goods or services through the normal competitive bidding process.

Similarly, departments frequently misused the State's emergency purchasing process by failing to meet the legal requirements for this type of procurement. For 17 of the 25 purchase requests we reviewed, the departments were requesting emergency purchases. In the remaining eight cases, the departments were requesting approval for reasons other than meeting emergency needs, such as seeking the purchase of items to meet special needs. Although General Services did not have the proper authority to grant exceptions for these purchases, it approved all eight.

Of the 17 emergency purchase requests totaling $21.3 million, nine totaling $2.3 million completely failed to identify the existence of an emergency situation that fell within the statutory definition or to explain how the proposed purchase was related to addressing the threat posed by an emergency.

State departments should require their legal counsel to review all sole-source contracts and emergency purchases to ensure they comply with statutes governing the use of noncompetitively bid contracts. Departments should also ensure that adequate time exists to properly plan for the acquisition of goods and services.

Moreover, General Services should require its Office of Legal Services to review all sole-source contract requests above a certain price threshold. General Services should also implement review procedures for sole-source contracts and emergency purchase orders to ensure that departments comply with applicable laws and regulations and require departments to submit documentation that demonstrates compliance. General Services should reject all sole-source and emergency purchase requests that fail to meet statutory requirements. Finally, General Services should seek a change in the current contracting and procurement laws if it wants to continue to exempt purchases from competitive bidding requirements because of special or unique circumstances.

General Services' Action: Partial corrective action taken.

General Services has implemented policies and procedures that provide for its Office of Legal Services to review all non-competitively bid contract requests that exceed $250,000. Additionally, General Services has developed a form that requires detailed information be provided to justify non-competitively bid procurements. Specifically, the form requires departments to provide detailed responses for various issues, including (1) why the acquisition is restricted to one supplier, (2) background events that led to the acquisition, (3) the consequences of not purchasing the good or service, and (4) what market research was conducted to substantiate the lack of competition. Finally, General Services is working to enhance the form to provide additional assurance that non-competitive procurements are properly justified.

Legislative Action: None.

General Services is reviewing the need for additional exemption authority related to competitive bidding. At this time, a final decision has not been made on the need to pursue additional authority in this area.

Finding #7: General Services needs to strengthen its oversight of state purchasing activities.

General Services has provided weak oversight and administration of the CMAS program. We found that General Services, which is responsible for auditing state departments for compliance with contracting and procurement requirements, is not performing the audits required by state law. Specifically, between July 1999 and January 2003, General Services had completed only 105 of 174 required reviews. Moreover, less than one-half of the 105 reviews were completed on time.

Additionally, General Services does not sufficiently review CMAS vendors to ensure that they comply with the terms of their contracts with the State. For instance, from July 1998 through September 2002, General Services had only reviewed 29 of 2,300 active CMAS vendors. Perhaps more importantly, General Services does not always make sure that other state and local government contracts on which CMAS contracts are based are, in fact, awarded and amended on a competitive basis. As a result, the State may be paying more than it should for the goods and services it purchases. Finally, General Services does not consistently obtain and maintain accurate data on departments' CMAS purchases. Consequently, it is sometimes charging other state departments more than it should for administrative fees. For example, we reviewed 90 CMAS purchases at nine departments and found 24 instances in which General Services had either entered the incorrect amount in its accounting system or had no record of the transaction. We further reviewed 10 of the 24 transactions and determined that General Services had overcharged departments more than $219,000.

We recommended that General Services implement the recommendations made by the Governor's Task Force on Contracting and Procurement Review (task force), which include increasing the frequency of audits and reviews of state departments. General Services should consider reducing or eliminating the delegated purchasing authority of departments that fail to comply with contracting and procurement

requirements. Additionally, General Services should increase the frequency of its reviews of CMAS vendors and ensure that processes established by other governmental entities for awarding and amending contracts are in accordance with CMAS goals. Finally, General Services should consult with departments to determine what can be done to facilitate monthly reconciliation of CMAS purchasing and billing activities.

General Services' Action: Partial corrective action taken.

General Services is committed to fully addressing the recommendations contained in the task force's report and is continuing to assign significant resources to that activity. For instance, General Services has initiated a cornerstone of the procurement reform effort—the training of state procurement officials. General Services has also implemented a system to track the volume and type of state procurement contracts. As a result, the State is now able to capture, through an internet-based system, data on all significant purchases on a near-real time basis. General Services has also facilitated meetings with the Department of Finance and departmental internal auditors to revise existing audit procedures to include CMAS and non-competitively bid contracts. Further, General Services is considering limiting its audits and reviews of some departments to an evaluation of the adequacy of the departments' most recent internal reviews. General Services noted that compliance with purchasing and contracting requirements is a major part of maintaining approved purchasing authority. If these requirements are not met, purchasing authority will be reduced or eliminated.

Although implementing a program that results in an increase in the frequency of vendor reviews is a priority, the State's current budget situation limits General Services' ability to obtain and assign additional resources to this activity. In the interim, General Services is focusing its limited resources on the review of the most frequently used CMAS suppliers. Finally, General Services believes that the implementation of a mandatory statewide electronic procurement system that would enable them to capture actual department purchasing activity in real time is the ultimate solution to its billing challenges. While General Services recognizes the importance of such a system, it is not feasible in the current fiscal environment. As an interim corrective action, General Services issued a memorandum to its customer departments advising them of the importance of regularly reconciling their purchasing information with invoices.

Finding #8: Although task force recommendations address most weaknesses, some cannot be immediately implemented and others are needed.

In August 2002, the task force recommended 20 purchasing reforms, completing its directive from the governor's Executive Order issued on May 20, 2002. The recommendations, which focus on the use of the CMAS program and noncompetitive bid contracts, call for comprehensive changes in the State's contracting and procurement procedures. Prompted by the controversy surrounding the Oracle enterprise licensing agreement, the governor asked the task force to review the State's contracting and procurement procedures and recommend the necessary statutory, regulatory, or administrative changes to "ensure that open and competitive bidding is utilized to the greatest extent possible." The task force's recommendations include the following:

- Departments must compare prices among CMAS vendors.
- Acquisitions of large information technology projects using CMAS contracts and master agreements should be prohibited unless approved in advance.
- General Services needs to establish specific criteria to qualify piggybacking vendors.[1]
- General Services should increase the frequency of its compliance reviews of purchasing activities of state departments.
- General Services should implement a new data integration system to address deficiencies in its ability to capture data and report on contracting and procurement transactions.

In general, we believe the task force's recommended changes, if properly implemented, should address many of the weaknesses in the CMAS program and noncompetitive bidding procedures we identified in our report. However, we believe that additional steps should be implemented based on the results of our audit. For example, General Services should revise its procedures for awarding contracts to vendors based on contracts they hold with other government entities because it often awards CMAS contracts without adequately evaluating the competitive-pricing processes that other state and local governments use to award base contracts.

[1] Vendors that do not have an existing federal multiple-award schedules contract but obtain a CMAS contract by agreeing to provide goods and services on the same terms as vendors that do have a multiple-award contract through the federal or some other government entity, are commonly referred to as piggyback contracts.

General Services also needs to develop classes that provide comprehensive coverage of sole-source contracts, emergency purchases, and CMAS contracts, and departments need to ensure that affected personnel attend the classes periodically. Also, because most of the departments we surveyed indicated they had experienced problems working with CMAS vendors, General Services should also consider holding periodic information sessions with the vendors. Further, in addition to implementing a new data integration system, which both General Services and the task force acknowledge is a long-term solution, we believe General Services should work with departments to establish a process to reconcile their purchasing information with invoices and reports prepared by General Services. Such reconciliation would allow departments to report and correct errors to General Services, thereby preventing incorrect billings and increasing the reliability of purchasing data. Finally, to increase departments' ability to access online information about the CMAS program, General Services should explore the possibility of including copies of vendor contracts on its Web site.

General Services' Action: Partial corrective action taken.

General Services is continuing to focus additional efforts on obtaining further assurance that processes used by other government entities to execute contracts are in accordance with CMAS goals. As part of this process, General Services has developed and implemented written policies and procedures that more clearly address this activity. Specifically, the CMAS analyst, through a review of documents and conversation with the awarding entity, must ensure that the process used by the awarding entity meets the State's standards for solicitation assessment.

As previously discussed, General Services has begun training of state procurement officials. In conjunction with the California State University at Northridge's Center for Management and Organization Development, General Services conducted an extensive survey of individuals involved in state purchasing activities. Based on this data, General Services is phasing in a series of new state acquisition courses. The first classes within General Services' comprehensive training and certification program were held on April 30, 2003. Additionally, the first classes within General Services' 64-hour Basic Certificate Program began on October 7, 2003.

Finally, according to General Services, while its Web site does provide a search tool by which departments can identify CMAS contracts by the categories of goods and services provided, departments are not able to access line-item detail on-line. Implementing a detailed catalog containing CMAS goods and services requires implementation of a comprehensive electronic procurement system. A dynamic software and hardware solution will be required to support the CMAS program, which has over 2,300 active contracts and more than 1,600 suppliers. At this time, the State's budget situation prevents the pursuit of this complicated and costly project.

DEPARTMENT OF INDUSTRIAL RELATIONS

Its Process for Verifying the Status of Licenses Issued to Farm Labor Contractors Is Operational but Needs Some Improvement

REPORT NUMBER 2001-017, SEPTEMBER 2002

Department of Industrial Relations' response as of October 2003

Audit Highlights . . .

Our review of whether the Department of Industrial Relations (department) has established a process for verifying the status of state licenses issued to farm labor contractors revealed that:

- ☑ *The department's process for verifying the status of farm labor contractors' licenses has been operational since July 1, 2002.*
- ☑ *Agricultural growers, farm labor contractors, and others can request license verifications through the department's Web site or by electronic mail, telephone, or facsimile.*
- ☑ *More oversight is needed of the department's license verification process, especially in these early stages of implementation.*

Chapter 157, Statutes of 2001, amended Section 1695.7(e) of the Labor Code, and required the labor commissioner in the Department of Industrial Relations (department) to establish a unit for verifying the status of farm labor contractors' licenses by July 1, 2002. According to the amended code, agricultural growers and farm labor contractors that subcontract work must verify that a farm labor contractor is properly licensed. The Bureau of State Audits was required to certify that the department's unit responsible for these verifications is operational. Based on our review, we found the following:

Finding #1: Although the department's license verification process is operational, the unit manager should exercise more oversight.

The department's new verification process is sufficient to certify the status of a farm labor contractor's license within one business day of receiving a request, provided employees follow established procedures. The unit manager oversees the verification process and has significant review capability over requests received and responded to electronically—the most common submission and delivery method. However, the unit manager is less able to monitor requests and responses to requests that are not electronic, such as requests received over the telephone or fax, or responses sent by fax or mail. Although the five employees assigned to the verification function are required to maintain folders containing documentation of fax and telephone requests and evidence of the corresponding responses, the unit manager had not had a chance to review these files at the time of our testing. Consequently, the unit manager has less assurance that telephone and fax requests as well as mail and fax responses are processed appropriately.

In addition, the unit does not accurately compile statistics concerning the number and types of verification requests received. The unit needs to have accurate information concerning its workload so it can assign an appropriate amount of resources to this function.

To ensure that the department is complying with the requirement that it respond to requests for verification of farm labor contractor licenses within one business day, we recommended that the unit manager exercise more oversight. For example, the unit manager could develop a log for employees to record the date, time, and medium (online, fax, e-mail, or telephone) by which a request is received; the date and time that the employee transmits the verification; and the method by which he or she transmitted the verification (e-mail, fax, or mail). The unit manager could then review the logs to ensure that a response was recorded for every request. The unit manager could also compare the number of requests received to the number of unique verification numbers issued. The logs would also provide statistical information on the unit's workload.

Department Action: Partial corrective action taken.

The department reports that the unit manager reviews all incoming e-mail and fax requests daily to ensure that responses have been made. The department asserts that it has responded to all requests received in a timely manner. ➲ However, the department's response does not explain how it ensures that telephone requests are processed appropriately.

Finally, the department reports that it has kept statistics that reflect the number of requests and the method by which they are received. ➲ However, the department's response does not address our finding that these statistics are inaccurate.

Finding #2: The department has not established dedicated telephone and fax lines for license verification requests.

The department has not established a dedicated telephone line for license verification requests. Consequently, unit employees who are not trained to perform verifications of farm labor contractors' licenses occasionally answer incoming telephone calls and attempt to gather relevant information from the requestor. This practice increases the chance of

miscommunication between the requestor and the unit employee working on the verification. Similarly, the department does not have a fax machine dedicated to license verification requests. Rather, faxed requests are received in a general work area by a fax machine used by the entire unit. The lack of a dedicated fax machine increases the risk of misplacing a faxed license verification request.

To reduce the possibility that a request for verification is lost or incorrectly handled, we recommended that the department consider obtaining dedicated telephone and fax lines and a fax machine for this function.

Department Action: Corrective action taken.

The department reports that it received 369 requests for verification of licenses via fax in the first 12 months of operation. The department does not believe it is necessary to have a fax machine dedicated to license verification requests.

Additionally, the department reports that it received 568 license verification requests over the telephone in the first 12 months. The department does not believe that it is necessary to incur the costs of installing a telephone line dedicated to this function.

Finding #3: The department does not accept telephone requests on all state business days.

Although the license verification Web site indicates that requests can be submitted by calling the Fresno or San Francisco office, neither office accepts telephone requests on Thursdays, and the San Francisco office does not accept telephone requests on Tuesdays as well.

To be more responsive to its customers, we recommended that the department consider taking telephone requests for license verification on all state business days.

Department Action: Corrective action taken.

The department reports that it now accepts telephone requests for license verifications on all state business days.

DEPARTMENT OF INDUSTRIAL RELATIONS

Investigations of Improper Activities by State Employees, August 2002 Through January 2003

ALLEGATION I2002-605 (REPORT I2003-1), APRIL 2003

Department of Industrial Relations response as of April 2003

Investigative Highlight . . .

A Department of Industrial Relations official claimed reimbursement for more than $17,000 in travel expenses to which he was not entitled.

We investigated and substantiated allegations that an official with the Department of Industrial Relations (department) improperly claimed reimbursements for relocation and commute expenses for travel between his residence near San Diego and his headquarters in San Francisco. We also found that the official improperly claimed payment for lodging and meals incurred within a close proximity of his headquarters. At the time we received the allegation, the department was already investigating these issues, and we asked that it report its findings to our office. The department concluded that the official improperly claimed $5,726 in travel costs related to relocation and lodging expenses. After receiving the department's report, we performed some additional analysis and follow-up work and determined that the official had claimed an additional $11,803 in improper travel expenses.

Finding #1: The official claimed relocation expenses but did not relocate.

The State reimbursed the official for relocation expenses when he neither relocated nor obtained the necessary approval for the reimbursement. The department found that $4,939 of the official's $4,982 claim for relocation expenses was improper, and it recommended disallowing these costs. However, the department allowed the remaining $43, which represents a 9-cent-per-mile reimbursement for relocation travel between the official's home near San Diego and his headquarters in San Francisco. However, we determined that the State should not have paid the $43 because the official did not relocate.

Department Action: Corrective action taken.

The department agrees with our finding and required the official to reimburse the State for improper relocation expenses totaling $4,982.

Finding #2: The official submitted improper claims for lodging and meal expenses.

The official made improper claims for lodging and meals. The department reported that the official improperly received $787 in reimbursement for unallowable lodging expenses that he incurred within 50 miles of his headquarters location. Our analysis determined that the official also improperly received $1,082 in meal and incidental expenses incurred within 50 miles of his San Francisco headquarters.

Department Action: Corrective action taken.

The department agrees with our finding and required the official to reimburse the State a total of $1,869 for lodging, meal, and incidental expenses incurred within 50 miles of his headquarters.

Finding #3: The official claimed and the department approved other unallowable and unnecessary expenses.

Of the $47,790 in travel costs the official incurred between April 2000 and November 2001, the State paid $2,334 for 24 days of lodging in San Diego, which is within 35 miles of the official's home, $3,941 for flights between San Diego and his San Francisco headquarters, and $3,768 more than he was entitled to receive for costs associated with flights between San Diego and Sacramento.[1]

We also found that the official claimed unnecessary rental car expenses. A portion of the rental car expenses the official claimed was for weekend rentals for which he stated no business purpose. Although the department did not address the issue, we found that of the $3,417 in rental car expenses the official incurred during the 20-month period we reviewed, $635 related to vehicles he rented in San Diego on weekends.

[1] The $47,790 includes $31,831 in travel claims that the official submitted for reimbursement and $15,929 in travel expenses not included on a travel claim, but that the State paid directly to a vendor. This figure does not include any relocation expenses.

Finally, we found that even though a majority of the $31,831 in travel claims that the official submitted lacked sufficient explanations for his trips, as state regulations require, the department approved his claims. We spoke with two executives about the department's process for reviewing and approving travel claims, because they had approved a number of the official's claims. Both executives told us they do not or usually do not attempt to verify the purpose of each trip listed on the claims.

Department Action: Partial corrective action taken.

The department reported that it will require an executive-level civil service officer familiar with state reimbursement rules to authorize all exempt employee travel claims before submitting them to the accounting department for processing. The department also reported that it will require a senior level (or higher) accounting officer to audit all exempt employees' travel claims before making payment.

➲ After the department began its investigation of the official's travel expenses, and well after the official had incurred the expenses and received reimbursement, the department decided that, for the purpose of determining which costs were valid and in compliance with state requirements, it would consider the official's San Francisco headquarters to be his "primary residence." This determination was based on the California Code of Regulations, Title 2, Section 599.616.1(b), which states that a place of primary dwelling shall be designated for each state officer and employee and that the primary dwelling shall be defined as the actual dwelling place that bears the most logical relationship to the employee's headquarters and shall be determined without regard to any other legal or mailing address.

➲ The department's determination that the official's primary dwelling was one and the same as the San Francisco headquarters allowed the official to travel between San Francisco and San Diego at state expense, based on the assumption that all such travel is for a business purpose. Consequently, the department did not recommend that the official repay the State for $2,334 in lodging expenses and $635 in rental car expenses he incurred in San Diego, the $3,768 overpayment for trips the official took between San Diego and Sacramento, or the $3,941 in airfare for flights between San Diego and San Francisco. Since the department determined that for the purpose of calculating travel expenses, the official's residence is his headquarters in San Francisco and not where he resides (near San Diego),

these expenses became allowable; however, we question this determination and find no indication that the official's headquarters is an "actual dwelling place." Moreover, the department does not appear to have used the best interests of the State as its guiding principle when making this after-the-fact determination that contradicted statements on the travel claims.

CALIFORNIA'S WORKERS' COMPENSATION PROGRAM

The Medical Payment System Does Not Adequately Control the Costs to Employers to Treat Injured Workers or Allow for Adequate Monitoring of System Costs and Patient Care

Audit Highlights . . .

Our review of the workers' compensation medical payments system revealed that:

- ☑ *Rising medical costs are contributing to the increasing costs of the workers' compensation system—costs California's employers are required to pay.*
- ☑ *Despite numerous warnings from research experts, the Division of Workers' Compensation (division) has done little to respond to the problems in the workers' compensation medical payment system.*
- ☑ *Fee schedules intended to control the amounts paid for medical services and products are outdated or nonexistent. The medical payment system lacks enforceable treatment guidelines that can help contain medical costs and streamline the delivery of medical care to injured workers. Researchers point to inadequate control over treatment utilization as a primary cause of escalating costs in the workers' compensation system.*

continued on next page

REPORT NUMBER 2003-108.1, AUGUST 2003

Division of Workers' Compensation, Department of Industrial Relations' response as of January 2004

The Joint Legislative Audit Committee requested that we review the medical costs related to the workers' compensation insurance system and the extent to which the payment structure has resulted in unacceptably high reimbursement rates.

Finding #1: Workers' compensation medical costs are rising because the medical payment system has not been well maintained or fully developed.

The costs of the State's workers' compensation program to employers are spiraling upward, and numerous studies point to the rising medical costs of treating injured workers as a major contributor to the problem. The Workers' Compensation Insurance Rating Bureau (rating bureau) reported that the average total estimated medical cost per workers' compensation claim involving lost work time increased by 254 percent from 1992 to 2002. The insurance premiums charged to employers to provide workers' compensation coverage increased from $5.8 billion to $14.7 billion between 1995 and 2002.

The medical costs of the workers' compensation system are rising in part because the State has not taken the necessary steps to ensure that the costs of treating injured workers are within reasonable limits. The administrative director of the Department of Industrial Relations' (Industrial Relations) Division of Workers' Compensation (division) is responsible for administering and monitoring the workers' compensation

- ☑ *Although the division could adopt fee schedules developed by other entities, such as Medicare, it would first have to decide on how to adjust those fee schedules to best meet the needs of the workers' compensation system.*
- ☑ *The division lacks a data collection system that allows it to monitor medical costs and measure the effectiveness of reforms made to the system.*

system. However, the administrative director has not maintained or fully developed the medical payment system. Despite mandates to biennially update the medical fee schedules for professional services, inpatient hospital facilities, and for medical products—such as pharmaceuticals and durable medical equipment—other than for minor adjustments, these schedules have not been updated since 1999, and they are essentially a patchwork of prior fee schedules.

In addition, costs for services performed at facilities such as outpatient surgical centers and emergency rooms are not covered by fee schedules but are paid on the basis of what are known as usual, customary, and reasonable charges for such services. Health care experts consider this basis for payment to be inflationary, and thus these charges may be contributing to the escalating costs in the workers' compensation system.

Numerous studies have pointed to opportunities to improve cost control in the system; however, the division has not built upon those studies to implement corrective actions. The division's administrative director states that the division has not been able to dedicate more effort to improving the medical payment system due in part to staff reductions, indicating that he has lost almost 17 percent of his authorized positions and 19 percent of his filled positions since fiscal year 1999–2000. He added that when he was appointed in 1999, he was instructed to place a greater priority on improving the workers' compensation judicial process.

Further, the Legislature and administration have sometimes responded to the needs of the system with measures that impede improvement, such as requiring the use of data not currently being collected to develop a new fee schedule for outpatient surgical facility charges and reducing the funding for tasks critical to improving cost control.

Because rising medical costs in workers' compensation contribute to increased costs to California's employers, we recommended that greater importance should be placed on more closely managing the costs of providing medical care to injured workers. As such, the administrative director should take the steps necessary to identify the organization and level of resources needed to effectively administer the workers' compensation medical payment system and should work with the Department of Finance and the Legislature to obtain those resources. In addition, as part of an effort to more closely manage the

medical payment system, the administrative director should more aggressively pursue corrective action needed to address issues identified in research reports, such as those from the Commission on Health and Safety and Workers Compensation (commission), the Industrial Medical Council (medical council), the California Workers' Compensation Institute, and the Workers' Compensation Research Institute, as well as any issues raised by internal studies conducted by Industrial Relations.

We further recommended that to ensure future legislation does not contain any unintended impediments to the improvement of the workers' compensation system, the administrative director should be proactive in working with the Legislature to identify and amend any provisions that would adversely affect the administrative director's ability to effect changes.

Industrial Relations' Action: Partial corrective action taken.

Industrial Relations believes that the enactment of Senate Bill 228 (Chapter 639, Statutes of 2003) should reduce the resources needed to adopt fee schedules. It reports that the division is currently reviewing its resources and assessing what specific expertise is needed.

Although Industrial Relations responded that the governor's proposal to further reform the workers' compensation system will address concerns from stakeholder groups and research organizations, its response does not address how it will more aggressively respond to issues raised by researchers and experts in the field that we describe in our report.

Industrial Relations reports that the Labor and Workforce Development Agency (agency) and the division worked very closely with the Legislature and the Governor's Office on the proposals that were included in the 2003 reform and are currently assisting the Governor's Office in developing and reviewing legislative proposals to build on existing reforms.

Legislative Action: Legislation proposed.

Conference committee convened.

Finding #2: A lack of effective utilization controls leads to higher medical costs.

The workers' compensation payment system lacks a process that would allow doctors to use a uniform set of treatment guidelines as a standard for treating similar workplace injuries and illnesses.

Medical treatment guidelines that provide standards for the treatment reasonably required to relieve the effects of workers' injuries, and that are presumed correct unless medical opinion establishes the need for a departure from those guidelines, can serve to ensure that injured workers receive the care they need to return to work, control medical costs, and increase the efficiency of the delivery of those medical services. Researchers point to inadequate controls over treatment utilization as a primary cause of escalating costs in the workers' compensation system. Overall, they report that in the area of professional medical services, California's average payment amount per claim is typical of other states, but the number of treatments per claim provided to injured workers is far above the average.

Despite the research pointing out the absence of utilization controls, California's system is without an effective process that would make treatment utilization review standards consistent among insurers. As a result, according to a study conducted by the division, there is little consistency in the processes or criteria used by insurers and claims administrators to determine the necessity of treatments proposed by physicians. In fact, one-third of the claims administrators included in the study reported using more than one set of criteria but did not provide a methodology for selecting which one they used for a particular case.

The medical council has developed treatment guidelines and it recently voted to review the medical evidence on treatment and utilization and to update its guidelines. However, the law requires that the medical council be made up of members of the medical community that would be subject to the treatment guidelines and maintain liaisons with the medical, osteopathic, psychological, and podiatric professions. As such, we question whether the medical council is the entity that can most effectively develop treatment guidelines without giving the appearance that it could be influenced by the extent to which the guidelines might adversely affect the financial interests of the medical community.

We recommended that the administrative director, in coordination with the medical council, should adopt a standardized set of treatment utilization guidelines, based on clinical evidence, to deter over- or underutilization of physician services and other professional medical services and products. The administrative director should consider, to the extent possible, adopting treatment guidelines that are developed by independent entities and that are

updated with adequate frequency to reflect advancing technology and changes in professional practice. If the administrative director adopts treatment guidelines developed by the medical council, he should take the steps necessary to ensure that those guidelines are developed without the appearance of undue influence from any group that participates in the State's workers' compensation system.

Industrial Relations' Action: Partial corrective action taken.

Industrial Relations points out the reforms in Chapter 639, Statutes of 2003, effective January 1, 2004, requires the division to adopt a medical utilization schedule by December 1, 2004, but did not state when it would update such a schedule. It further states that the new reforms eliminated the medical council, thereby making moot the recommendation to consult with it on treatment utilization guidelines.

Industrial Relations states that the commission (an independent entity) will survey and evaluate existing medical treatment utilization standards and that it expects the commission's findings and recommendations by July 1, 2004. Industrial Relations states that until December 1, 2004, the most recent update of the American College of Occupational and Environmental Medicine Occupational Medical Practice Guidelines are presumed to be correct in determining the extent and scope of medical treatment.

Finding #3: The current legal and regulatory structure for utilization control is ineffective.

A primary cause of the lack of effective utilization controls is that under the current law, utilization reviews are usually not admissible as evidence in judicial proceedings to resolve disputes between medical providers and claims administrators. To be admissible as evidence, a decision reached through a utilization review would need to be supported by a report from a physician performing an examination of the injured worker—a level of review not typically used by insurers and claims administrators when approving payment for treatment. Therefore, utilization reviews prepared by claims administrators have no weight in judicial proceedings.

In addition, the law requires that the administrative director adopt model utilization protocols in order to provide utilization review standards and requires insurers and claims administrators

to comply with those protocols. However, the regulations adopted by the former administrative director do not establish utilization review standards based on utilization protocols but instead allow insurers to establish their own unique utilization review plans as long as they meet certain administrative requirements. We believe that the regulations fail to achieve the objective of using utilization reviews to contain medical costs. However, the administrative director stated that he does not believe he has the statutory authority to make utilization reviews mandatory for insurers.

The absence of an effective utilization control process leads to disagreements between medical providers and claims administrators over proposed treatments for injured workers. However, the system does not have an effective process for resolving those disputes. Under the current dispute resolution structure, unresolved disagreements are finally settled by the Workers' Compensation Appeals Board after going through the judicial process within the workers' compensation system. Lacking a more efficient intermediary process, nearly 20 percent of the workers' compensation cases end up going through this judicial process. This lengthy process of resolving disputes can prolong the duration of workers' compensation cases.

To ensure that the treatment guidelines can serve as an authoritative standard for the treatment of workers' injuries, we recommended that the administrative director should seek the changes necessary in the Labor Code to ensure that all insurers and claims administrators are required to follow the standardized treatment guidelines and that treatment guidelines are accepted for use in judicial proceedings.

In addition, after obtaining any needed amendments to the law the administrative director should amend the division's regulations to reflect those changes to the law. Specifically, the division's regulations should require that insurers and claims administrators adhere to the standardized treatment guidelines and should clearly define the role of treatment guidelines in determining treatment and in judicial proceedings.

Industrial Relations' Action: Pending.

Industrial Relations stated that the new reforms provide that upon adoption by the administrative director of a medical utilization schedule, the schedule shall be presumptively correct on the issue of extent and scope of medical treatment. According to Industrial Relations, the new law will ensure that insurers and claims administrators follow the treatment guidelines in the schedule, and that the guidelines are accepted in judicial proceedings.

Industrial Relations also states that the division is in the process of drafting new utilization review regulations to implement the new reforms.

Legislative Action: Legislation proposed.

Conference committee convened.

Finding #4: Proposed changes to the medical payment system may control fees for medical services and products but do not ensure lower overall medical costs or access to quality care.

The administrative director and the commission have presented two different proposals for improving medical cost controls using variations of Medicare-based fee schedules. The Medicare payment system for physician services is founded on a valuation of the resources needed to provide each service. This system is known as the resource-based relative value scale (RBRVS) system.

Basing part or all of the workers' compensation system on the Medicare RBRVS system would have several advantages, among them the values on which payments are based would be derived from the amount of resources needed to perform services, rather than on customary charges. In addition, Medicare updates its schedules regularly, and so the values would remain current. Health policy experts believe resource-based systems to be less inflationary than charge-based ones. However, because the payments are resource based, it is projected that for some medical specialties, such as surgery and anesthesia, the payment amounts would be reduced from the traditional charge-based payments, and payments for evaluation and management services would be increased. This redistributive effect of the RBRVS system is a major point of controversy among providers of these affected medical specialties, in spite of the RBRVS system's ability to contain costs.

More work is needed to ensure that injured workers have access to quality care at reasonable costs to employers. If the State adopts a payment system that is based on indexed values, such as the RBRVS, it will need to determine how to adjust the RBRVS to arrive at payments that will meet this objective. There is no universal way to make these adjustments. Other states that have implemented a payment system based on the RBRVS have used a variety of approaches in adapting the system to fit their needs. Some considerations the State must weigh include the need to balance adequate access to care against overutilization and whether a transition strategy may be needed to mitigate the effects of the payment redistribution that would be caused by an RBRVS payment system.

We recommended that when determining the future structure of the workers' compensation medical payment system, the administrative director should consider the costs and practicalities of maintaining such a complex system and should give consideration to adopting a payment system that is based on models that are maintained by other entities, such as a variation of the RBRVS maintained by the federal Centers for Medicare and Medicaid Services, as he has done with his current proposal for modifying the physician fee schedule. If the administrative director decides to continue modifying the current workers' compensation payment system, he should consider pursuing a variety of activities, including the following:

- Continue his efforts to identify the adjustments needed to ensure that payments for services in the proposed modified physician fee schedule are high enough to encourage participation by physicians and other professionals in order to provide adequate access to care for injured workers.

- Seek the needed resources to develop and maintain fee schedules for the remaining medical services and products, such as outpatient surgical facilities, pharmaceuticals, emergency rooms, durable medical equipment, and home health care.

One proposal to improve California's workers' compensation payment system requires converting the entire system to a combination system that would use a variation of the Medicare payment system for medical services, facilities, and products, and the Medi-Cal payment system for pharmaceuticals. If this proposal is adopted, the administrative director should consider the following steps:

- Develop adjustments to the fee schedule for physician services and other professional services so as to mitigate any effects on access to care caused by adopting a resource-based relative value payment system that results in redistributing payment amounts away from medical specialties, such as surgery, and in increasing payments for evaluation and management services.

- Monitor the medical payment system to determine whether a reasonable standard of care can be achieved at the capped prices for services and products contained in the proposal.

- To fully benefit from adopting the Medi-Cal payment system for pharmaceuticals, in addition to adopting the Medi-Cal fee schedule, the administrative director should also study the feasibility of establishing a process to secure rebates from drug manufacturers like the supplemental rebates enjoyed by the Department of Health Services in its Medi-Cal pharmaceuticals purchase program.

Because there are no universally successful formulas for determining payments for medical services and products, we recommended that the administrative director should consult also with other states that have adopted Medicare-based payment systems and consider any measures they have employed to secure quality care at reasonable prices.

Industrial Relations' Action: Pending.

Industrial Relations reports it is taking the following steps to address the recommendations we made above:

- The reforms that took effect on January 1, 2004, revised the existing medical payment system by repealing the existing Official Medical Fee Schedule language and replacing it with provisions that require reimbursement of pharmaceuticals at 100 percent of the Medi-Cal rate; and that inpatient hospital services and outpatient surgeries that occur in either a hospital or ambulatory surgical center be reimbursed at no more than 120 percent of the relevant Medicare rate.
- To gauge access to care, the division's administrative director is preparing to contract with the University of California to conduct a study of injured workers' access to medical treatment. The initial study is to be conducted in 2004 using funding from existing resources.

- Industrial Relations believes that the legislative changes in Chapter 639, Statutes of 2003, should reduce the resources needed to adopt fee schedules. The division is currently reviewing its resources and assessing what specific expertise is needed. Since the hospital, outpatient, and pharmaceutical fee schedules are based on data already compiled by government entities outside the division, the resources required by the division for these fee schedules may be available within existing resources.
- The new reforms require that the existing Official Medical Fee Schedule for physician services be reduced by 5 percent and remain in effect until January 1, 2006, at which time the administrative director has the authority to adopt a new physician fee schedule.
- The reforms require the administrative director to contract for an independent annual study of access to medical treatment for injured workers. If it is found that access to quality health care or products is insufficient, the administrative director may make appropriate adjustments to medical and facilities' fee schedules.
- The division will study the feasibility of securing rebates from drug manufacturers for pharmaceuticals dispensed in workers' compensation cases. However, Industrial Relations notes that because workers' compensation in California is not designed as a single payer system, the division may be limited in its ability to negotiate lower pharmaceutical prices.
- Finally, Industrial Relations states that the division has been in contact with virtually all other states through the International Association of Industrial Accidents Boards and Commissions (IAIABC) and will consult with those states with Medicare-based payment systems.

Finding #5: The division lacks a data collection system that is adequate to monitor the workers' compensation system.

The division does not currently have a data collection system that will allow it to perform the necessary research to monitor the effect of policy decisions on the quality and availability of care to injured workers. Although legislation that took effect in 1993 mandated the development of a data collection system,

the Workers' Compensation Information System (WCIS) is still incomplete. According to the division, intense opposition to data collection from insurers, a shortage of knowledgeable and experienced staff, and technical difficulties in installing the proper hardware and software infrastructure have delayed the implementation of the WCIS. The division still has not identified a projected completion date for the system.

The WCIS consists of three components: two are used to collect information on the nature and duration of workplace injuries, and the third collects data on medical treatments and payments. The first two components are complete and operational, but the division is still working to identify the types of medical data it needs to collect to provide useful information for monitoring the performance of the medical payment system. However, the division has not provided us with any assurance that the medical data it collects will generate the information required to meet the statutory objectives for the system. According to the administrative director, identification of the needed medical data has been slow due in part to the effort required to work through the concerns the insurers have about the cost of reporting the data.

Further, the division stated that, if its funding is stabilized by passage of a state budget that includes employer user fees or sufficient General Fund moneys, and if the proposed funding augmentation for Assembly Bill 749 is made, it will identify a timeline for completing the medical data collection module of the WCIS expansion. The 2003–04 Budget Act includes both employer user fees and an augmentation to fund Assembly Bill 749 mandates.

Now that the division's budget contains employer user fees and a spending augmentation the administrative director asserts is needed to complete the division's WCIS, we recommended that the administrative director should place the WCIS implementation project on a timeline to facilitate its completion as quickly as possible. In addition, the administrative director should exercise the authority necessary to ensure that the data collected in the WCIS will provide the information needed to adequately monitor medical costs and services.

Industrial Relations' Action: Pending.

Industrial Relations states that division staff is working closely with staff from the Information Systems Unit to design, develop, and implement a prototype model for medical data collection. The division developed a proposed list of medical data elements to be collected, based on IAIABC guidelines. The division plans to reduce the number of data elements, based on an analysis of the ability to collect each data element and its anticipated usefulness.

The major remaining obstacle to the ability of the WCIS to collect medical data elements is the cooperation of claims administrators, who may not be capturing the data elements the division believes necessary to adequately analyze medical treatment. Initial data has been received from the State Compensation Insurance Fund.

CALIFORNIA LAW ENFORCEMENT AND CORRECTIONAL AGENCIES

With Increased Efforts, They Could Improve the Accuracy and Completeness of Public Information on Sex Offenders

Audit Highlights . . .

*Our review of the Department of Justice's (Justice) database of **serious** and **high-risk** sex offenders, known as the Megan's Law database, disclosed the following:*

- ☑ *The Megan's Law database contains thousands of errors, inconsistencies, and out-of-date information.*
- ☑ *Because it excludes records for some serious and high-risk sex offenders and erroneously lists others as incarcerated, the Megan's Law database does not inform the public about these offenders.*
- ☑ *Conversely, because it includes hundreds of duplicate records and erroneously indicates that 1,142 incarcerated sex offenders are free, it may unnecessarily alarm the public.*
- ☑ *The address information for roughly 23,000 records in the Megan's Law database has not been updated for at least a year largely because sex offenders have not registered.*

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REPORT NUMBER 2003-105, AUGUST 2003

Department of Justice's response as of December 2003

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to evaluate the accuracy of the State's database of registered sex offenders. Further, the audit committee asked us to determine if state and local law enforcement agencies are implementing Megan's Law in a manner that maximizes the registration data's accuracy. Lastly, we were asked to identify deficiencies in the current state Megan's Law that hinder the accuracy of the sex offender data and to provide legislative recommendations to address identified deficiencies.

Finding #1: The Megan's Law database omits some records of juvenile sex offenders tried in adult courts, and inappropriately includes others.

The law provides that only juveniles with juvenile court adjudications for their sex offenses are protected from public disclosure under Megan's Law. However, we found omitted from the Megan's Law public information a total of 51 Department of the Youth Authority (Youth Authority) records of juvenile sex offenders tried in adult courts. In 20 cases, Department of Justice (Justice) staff did not mark the records as coming from adult courts; in 31 other cases, Youth Authority or Department of Corrections (Corrections) did not prepare pre-registration or notification forms or Justice did not receive or process them. Without information about *serious* and *high-risk* juvenile sex offenders tried in adult courts and released into communities, California residents have no way of knowing that they are living near these convicted offenders.

In addition to problems with the overall accuracy of the Megan's Law database, we found that Justice does not always prevent the public disclosure of juvenile sex offenders' records. Specifically, Justice erroneously disclosed to the public 42 records for sex

☑ *Although Justice maintains that its primary responsibility is to compile the sex offender data it receives from law enforcement agencies and confinement facilities, it has taken steps to improve the accuracy of the information in the Megan's Law database.*

offenders convicted in juvenile courts, thwarting the additional protection and confidentiality that the Legislature has afforded to juveniles.

To ensure that the records of juvenile sex offenders are properly classified and disclosed to the public, we recommended that Justice do the following:

- Coordinate with the Youth Authority and periodically reconcile its sex offender registry with Youth Authority information.
- Provide training to its staff regarding the proper classification of records, such as flagging juvenile records appropriately for public disclosure.
- Revise its pre-registration process with Youth Authority to include a request for court information, which can be used to properly classify juvenile records.
- Request the Judicial Council to amend its juvenile commitment form to require that Youth Authority send a copy of the form to Justice.

Justice Action: Partial corrective action taken.

Justice reports that it worked with Youth Authority to develop an automated process for updating juvenile sex offender status in the Violent Crime Information Network (VCIN) with Youth Authority data. Justice has implemented this process and plans to use it to update the VCIN monthly. It is working on other modifications that will improve data synchronization between Justice and Youth Authority, and plans to complete them by the end of January 2004. Justice also implemented new procedures and trained its staff to ensure that all juvenile sex offender records are properly classified for purposes of public disclosure. Additionally, the Judicial Council is evaluating legal issues associated with Justice's request for Youth Authority to provide more detailed court disposition information with sex offender registration documents to help facilitate the classification process.

Finding #2: The Megan's Law database omits some records with inaccurate offense codes.

Of approximately 18,000 records in the VCIN that are classified as "other" and not shown to the public, Justice identified 1,900 records that have offense code 290 rather than the more specific

offense codes for which the sex offenders were convicted. Local law enforcement agencies and Justice staff sometimes enter the 290 offense code in reference to the section of the California Penal Code that mandates registration for sex offenders when they are uncertain of the appropriate code, and the VCIN automatically classifies records with this offense code as "other." Records classified as other are not included in the Megan's Law database and thus not disclosed to the public. Justice ultimately determines the proper offense code by researching conviction information, but stated that until recently it has not had the necessary staffing resources to do the work. Justice subsequently updated the offense code for 497 of the 1,900, raising the classification to serious for 351 of them. For most of the remaining 1,403 records, Justice is waiting for responses from other states.

We recommended that Justice continue reviewing records for which it has only the 290 offense code and update the offense codes as appropriate.

Justice Action: Corrective action taken.

Justice continues to review criminal history information to verify that registered sex offenders are properly classified for purpose of public disclosure in the Megan's Law database. As of December 9, 2003, Justice has reviewed approximately 15,500 of the approximate 18,000 sex offenders classified as "other," resulting in the reclassification of 1,390 of these sex offenders to "serious." Justice is in the process of researching the remaining 2,500 records, most of which have offense code 290, and has requested conviction information from courts.

Finding #3: Some sex offender records continue to indicate the incarcerated status after offenders are discharged from prison or paroled, while others show incarcerated sex offenders as residing in local neighborhoods.

We found that for 582 records in VCIN that indicate the offenders are in prison, there were no records with matching Criminal Information and Identification (CII) numbers on Corrections' list of inmates. A sample of 59 of these revealed that 48 of the offenders were no longer in prison. Another 1,142 records incorrectly indicate the sex offenders are free when, in fact, they are incarcerated. Additionally, of 2,575 records Justice identified as pending release from prison for more than a year, 1,787 of these offenders had already been released. Because Justice does not review Corrections' monthly list of prison inmates to identify sex offenders who

appear on the list one month but not the next, it does not know if Corrections should have completed a form notifying Justice and local law enforcement that it will soon be releasing a sex offender or that one has died, and Justice does not know which offenders require follow-up to determine their true status. Unless Justice corrects these records or these offenders register, their records in the Megan's Law database will continue to incorrectly indicate that they are incarcerated.

We recommended that Justice regularly compare its records showing the incarcerated status with information provided by Corrections to determine which sex offenders are confined and those who are no longer in confinement, continue to work with Corrections to improve this process, and produce exception reports to resolve those records in question. Justice can then update these records appropriately.

Justice Action: Pending.

Justice is in the process of modifying the program it uses to update the VCIN using Corrections' list of incarcerated sex offenders, so that an offender's incarceration status will be removed from the Megan's Law database when it no longer appears on Corrections' list. The offender's status will automatically change to "released" and a violation notice will be activated if the offender does not register with local law enforcement as required. Justice is also modifying the VCIN to generate violation notices based on the date of release, rather than on the date of notification, as reported in the pre-release notification documents. Justice anticipates it will complete these changes by the end of January 2004. According to Justice, these changes will significantly reduce future discrepancies between Justice's and Corrections' data.

To the extent possible, Justice and Corrections will pursue other methods for ensuring complete synchronization of sex offender data. However, Justice believes that it would not be practical to generate monthly exception reports as a means of identifying any sex offender records that cannot be properly matched to Corrections' data. It says that the use of such reports would be extremely time-consuming, since it would potentially require the manual research of thousands of possible matches each month.

Finding #4: The Megan's Law database includes hundreds of duplicate records primarily created by personnel who lack adequate training.

We identified 437 records in the Megan's Law database that were obvious duplicates of other database records. Consequently, the public cannot rely on the sex offender information shown in a zip code search to identify the number of offenders in a specific community. The public also cannot rely on the information retrieved from the Megan's Law database in response to a search for a specific sex offender by name, because more than one record can appear for an offender and, without dates on the records, the public cannot determine which record is the most current.

Personnel who update sex offender records create duplicate records because they do not always search for existing records before creating new ones. According to Justice's policies and procedures, when a sex offender registers, personnel updating sex offender records are required to search the database to determine if the offender matches existing records. However, Justice has not provided sufficient training to its personnel and to all local law enforcement agencies that update sex offender records. For example, we found that personnel at one city's police department entered 89 of the 437 duplicate records.

We recommended that Justice periodically analyze its data to identify and eliminate obvious duplicates. As a first step, Justice should review the bureau's analysis identifying obvious duplicate records and eliminate these duplicate records. Additionally, to ensure that local law enforcement and its own staff update sex offender information appropriately, we recommended that Justice design and implement an appropriate training program.

Justice Action: Partial corrective action taken.

Justice has implemented an improved system for identifying duplicate records in the VCIN through a specially designed data-string search and manual verification process. As a result of the initial search conducted in August 2003, Justice identified and eliminated 512 duplicate records from the database. In late October 2003, Justice began these searches on a weekly basis and as of December 9, 2003, identified 273 additional duplicate records, which it has merged and deleted. These weekly searches will augment the existing process of identifying duplicate records based on a cross match of CII numbers.

In addition, by mid-2004 Justice plans to complete the programming necessary to implement Live Scan, an electronic fingerprinting technology, allowing local law enforcement agencies to electronically transmit to Justice the offenders' fingerprints with each registration transaction. The fingerprints will be automatically verified for immediate and reliable identity confirmation, which according to Justice, will eliminate duplicate entries.

Also, Justice has been working with local law enforcement agencies to research and identify options for providing a statewide training program designed to improve the accuracy of sex offender data from both data entry and field enforcement standpoints. To determine how best to deploy its limited training staff, Justice has been soliciting local agency input regarding their need for training and other assistance through field contact, surveys, and a regional law enforcement meeting. Based on this input, Justice will modify its existing technical training program to focus on problem areas, incorporate enforcement strategies in the curriculum, and achieve greater efficiency through regional training it facilitates. Justice has trained its staff who process registration information in order to minimize technical errors that may contribute to data inaccuracy and plans to conduct this internal training on an ongoing basis.

Finding #5: The Megan's Law database does not show when sex offenders' records were updated, limiting the information's usefulness to the public.

Because the Megan's Law database does not include the dates of offenders' registrations, the public has no way of distinguishing the records recently updated from those updated long ago, thereby limiting the usefulness of the information. We found that approximately 23,000 records were last updated before April 2002, and about 14,000 of those were last updated before April 1998. Often, registrants do not comply with annual registration requirements, and many offenders with outdated information are not required to register in California because they may have moved outside the State, been deported or incarcerated, or are deceased. Without information in the Megan's Law database to tell them whether the last update was a week or five years ago, or a specific disclaimer explaining the possibility of outdated data, people viewing the database cannot evaluate the usefulness of the information they read.

We recommended that Justice modify the Megan's Law database to include the date that the registration information was last provided.

Justice Action: Corrective action taken.

Justice has modified the Megan's Law database to include a message indicating if and for how long an offender has been in violation of registration requirements. According to Justice, the message reads: "Note: This sex offender has been in violation of registration requirements since <date>." Justice states that vendors are developing foreign language translations of this message and anticipates adding them to the Megan's Law database by February 2004.

Finding #6: The public would be well served by Justice attaching disclaimers to the Megan's Law database.

Even if state and local agencies accurately reported all the information they receive, the Megan's Law database would continue to be incomplete and inaccurate as a result of sex offenders not registering as required or providing inaccurate information when they do register. Currently, Justice includes some disclaimers in the information it provides the public. However, we believe that modifying the existing disclaimers and adding others about potential inaccuracies and errors could help the public better understand and use the data to protect themselves and their families. As of the end of our audit, Justice was in the process of finalizing additional disclaimers that incorporate our suggestions.

We recommended that Justice finalize its disclaimer information and direct law enforcement agencies to provide the disclaimers to the public members who view the Megan's Law database. The disclaimer information should include the following:

- A statement that Justice compiles but does not independently confirm the accuracy of the information it gathers from several sources, including sex offenders who register at law enforcement agencies and custodians who report to Justice when sex offenders are released from confinement facilities. This statement should advise the viewer that the information can change quickly and that it would not be feasible for California's law enforcement agencies to verify the whereabouts of every sex offender at any given time.

- A statement that the information is intended not to indicate the offenders' risk to the public but to help people form their own assessments of risk.

- A statement that the location information is based on the "last reported location," which may have changed.

- A statement to remind viewers that a fingerprint comparison is necessary to positively identify a sex offender.

Justice Action: Corrective action taken.

Justice developed a comprehensive disclaimer containing the specific elements we recommended and has added the English version of this disclaimer to the Megan's Law database. Justice anticipates that translations of the disclaimer in 12 other languages will be added to the Megan's Law database by mid-January 2004.

Finding #7: Justice's review of the Megan's Law data has not been adequate.

State law declares the Legislature's intent that Justice continuously reviews the sex offender information in the Megan's Law database. However, Justice has interpreted this intent language to direct it only to continually review the accuracy of its entry of information, not of the information itself. Our legal counsel agrees with Justice that the intent language is not binding and states that because Justice is responsible for administering the Megan's Law database, it has flexibility in determining how it will fulfill the Legislature's intent that it continually review sex offender data. However, we believe Justice's review has not been adequate because the Megan's Law database is intended for the public's use in safeguarding itself from dangerous sex offenders. According to Justice, because it is only a repository, not the originating source, of much of the Megan's Law information, it is beyond the purview of Justice to ensure that information provided by courts and registering agencies is accurate.

The Associated Press reported in January 2003, based on information provided by Justice, that Justice did not know the whereabouts of 33,296 registered sex offenders because they had not registered annually as required. Subsequently, Justice determined that 663 of the 33,296 sex offenders had, in fact, registered within the past year. In addition, Justice confirmed that 2,833 sex offenders are living outside the State and

1,360 are deceased. However, Justice received either outdated, incomplete, or no information on the remaining 28,440 sex offenders who did not register.

Justice obtained information on deaths from the Department of Health Services (Health Services), deportations from the Immigration and Naturalization Service (INS), and sex offenders living in other states from the National Law Enforcement Telecommunication Services. However, until 2003, Justice had not requested death information to use for updating sex offenders' records. According to Justice, previously it did not obtain the information from Health Services or the INS because it has no underlying statutory responsibility for seeking out information from these agencies.

We recommended that Justice design and implement a program to check the data as a whole for inconsistencies and periodically reconcile the data with other reliable information. Additionally, we recommended that Justice continue to work with Health Services, the INS, and other public agencies to obtain valuable information and update the sex offenders' records.

Justice Action: Corrective action taken.

Justice has contracted with Health Services and the Social Security Administration to regularly obtain updated death certificate information. It will use this information on a quarterly basis to update sex offender information in the VCIN. Also, Justice recently compared records in the VCIN with deportation records maintained by the INS and updated the VCIN to reflect offenders identified as deported. In November 2003, Justice obtained on-line access to INS' deportation files, which will enable it to identify on an ongoing basis sex offenders who have been deported. In addition, Justice has begun ongoing analysis of its sex offender database to identify and correct record errors, which includes a series of special searches for key words and unique transaction sequences that may indicate possible data entry errors.

DEPARTMENT OF HEALTH SERVICES

It Needs to Better Plan and Coordinate Its Medi-Cal Antifraud Activities

Audit Highlights . . .

Our review of the Department of Health Services' (Health Services) activities to identify and reduce provider fraud in the California Medical Assistance Program (Medi-Cal) revealed the following:

- ☑ *Because it has not yet assessed the level of improper payments occurring in the Medi-Cal program and systematically evaluated the effectiveness of its antifraud efforts, Health Services cannot know whether its antifraud efforts are at appropriate levels and focused in the right areas.*
- ☑ *Health Services has not clearly communicated roles and responsibilities and has not adequately coordinated antifraud activities both within Health Services and with other entities, which has contributed to some unnecessary work or ineffective antifraud efforts.*
- ☑ *An updated agreement with the California Department of Justice could help Health Services better coordinate investigative efforts related to provider fraud.*

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REPORT NUMBER 2003-112, DECEMBER 2003

Departments of Health Services' and Justice's responses as of December 2003

The Joint Legislative Audit Committee (audit committee) asked us to review the Department of Health Services' (Health Services) reimbursement practices and the systems in place for identifying potential cases of fraud in the Medi-Cal program, with the aim of identifying gaps in California's efforts to combat fraud. Many of the concerns we report point to the lack of certain components of a model fraud control strategy to guide the various antifraud efforts for the Medi-Cal program. Specifically, we found:

Finding #1: Health Services lacks some components of a model fraud control strategy.

Although Health Services has received many additional staff positions and has established a variety of antifraud activities to combat Medi-Cal provider fraud, it lacks some components of a comprehensive strategy to guide and coordinate these activities to ensure that they are effective and efficient. Specifically, it has not yet developed an estimate of the overall extent of fraud in the Medi-Cal program. Without such an assessment, Health Services cannot be sure it is targeting the right level of resources to the areas of greatest fraud risk. The Legislature approved Health Services' 2003 budget proposal for an error rate study to assess the extent of improper payments in the Medi-Cal program, and Health Services is just beginning this assessment.

In addition, Health Services has not clearly designated who is responsible for implementing the Medi-Cal fraud control program. A model antifraud strategy involves a clear designation of responsibility for fraud control, which in turn requires someone or a team with authority over the functional components that implement the antifraud program. Although Audits

- ☑ *Because it lacks an individual or team with the responsibility and authority to ensure fraud control issues and recommendations are promptly addressed and implemented, some well-known problems may go uncorrected.*
- ☑ *Health Services does not obtain sufficient information to identify and control the potential fraud unique to managed care.*

and Investigations (audits and investigations) is the central coordination point for antifraud activities within Health Services, some antifraud efforts are located in other divisions and bureaus of Health Services or in other state departments over which audits and investigations has no authority. Thus, audits and investigations' designation as the central coordination point within Health Services does not completely fill the need for an individual or team that crosses departmental lines and is charged with the overall responsibility and authority for detecting and preventing Medi-Cal fraud.

Rather than measuring the impact of its efforts by the amount of reduction in fraud, Health Services measures its success by reference to unreliable savings and cost avoidance estimates. A component of a model antifraud strategy requires evaluating the impact of antifraud efforts on fraud both before and after implementation of the effort. However, Health Services measures its efforts by the achievement of goals established during the development of its savings and cost avoidance estimates. Although antifraud efforts offer savings, they also need to be measured against their effect on the overall fraud problem to determine whether the control activities should be adjusted.

Finally, Health Services does not currently have processes to ensure that each claim faces some risk of fraud review. According to Health Services, although its current claims processing system subjects each claim to certain edits and audits, it does not subject each claim to the potential for random selection and in-depth evaluation for the detection of potential fraud. The 2003 budget proposal included establishing a systematic process to randomly select claims for in-depth evaluation and this is one of the components the Legislature approved.

We recommended that Health Services develop a complete strategy to address the Medi-Cal fraud problem and guide its antifraud efforts. This should include adding the currently missing components of a model fraud control strategy, such as an annual assessment of the extent of fraud in the Medi-Cal program, an outline of the roles and responsibilities of and the coordination between Health Services and other entities, and a description of how Health Services will measure the performance of its antifraud efforts and evaluate whether adjustments are needed.

Health Services' Action: Pending.

Health Services stated that it is in the process of implementing the model fraud control strategies. It has received federal funding for evaluating and measuring payment accuracy and will develop plans for annual payment accuracy studies that will aid in allocating resources and evaluating fraud deterrence and detection efforts. Health Services also stated that it will document the roles and responsibilities of the various programs participating in antifraud efforts and will work with the Health and Human Services Agency to improve the coordination of antifraud activities with other departments under its authority.

Finding #2: Health Services has not yet conducted routine and systematic measurements of the extent of fraud in the Medi-Cal program.

Health Services has not systematically assessed the amount or nature of improper payments in the Medi-Cal program. Improper payments include any payment to an ineligible beneficiary, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for applicable discounts. Without this information, Health Services does not know whether it is overinvesting or underinvesting in its payment control system, or whether it is allocating resources in the appropriate areas.

The Legislature approved portions of Health Services' May 2003 budget proposal including an error rate study and random sampling of claims. Building upon its authorization to conduct an error rate study, in August 2003 Health Services applied to the federal Centers for Medicare and Medicaid Services to participate in its Payment Accuracy Measurement (PAM) project for fiscal year 2003–04. In its PAM proposal, Health Services stated that it would develop an audit program to accomplish certain objectives, including identifying improper payments, and a questionnaire to confirm that a beneficiary actually received the services claimed by the provider. However, until Health Services completes its audit program and procedures, it is premature to conclude on the adequacy of its approach to verify services with beneficiaries to estimate the level of fraudulent payments.

We recommended that Health Services establish appropriate claim review steps, such as verifying with beneficiaries the actual services rendered, to allow it to estimate the amount of fraud in the Medi-Cal program as part of its PAM study. We also recommended that it ensure the payment accuracy benchmark developed by the PAM model is reassessed by annually monitoring and updating its methodologies for measuring the amount of improper payments in the Medi-Cal program.

Health Services' Action: Pending.

Health Services reported that it will ensure an appropriate claim review step is included to verify with the beneficiary that actual services were rendered. It also plans to reassess monitoring and measurement methodologies annually.

Finding #3: Health Services does not evaluate the effect on the extent of fraud of its antifraud activities and uses unreliable savings estimates.

Health Services does not perform a cost-benefit analysis for each of its antifraud activities, nor does it use reliable savings estimates to justify its requests for additional antifraud positions. According to Health Services, it uses a form of cost-benefit analysis, using estimated savings or cost avoidance as the benefit, to make decisions regarding resource allocations. Health Services indicated that it looks at the costs and savings of its antifraud activities in the aggregate and not by specific activity because not all the fraud positions it received are directly involved in savings and cost avoidance activities. Although it acknowledged that it does not use a formal cost-benefit analysis, Health Services asserts that it performs an intuitive type of assessment.

Health Services computes a savings and cost avoidance chart (savings chart) to estimate the savings it expects to achieve from its antifraud activities in the current and budget year. Health Services also uses the savings chart to quantify the achievements of each of its antifraud activities in the prior year and as a management tool to allocate resources. Health Services used the savings chart it created in November 2002 to support its request for 315 new positions for antifraud activities in its May 2003 budget proposal, of which the Legislature ultimately approved 161.5 positions.

However, Health Services' November 2002 savings chart potentially overstates its estimated savings because of a flaw in the methodology it uses to calculate the savings. Health Services

calculates its savings and cost avoidance estimates for some categories by using the average 12-month paid claims history of providers who have been placed on administrative sanctions. Health Services assumes that 100 percent of the claims it paid during the prior 12-month period to those providers sanctioned in the current year would be savings in the budget year. However, it does not perform any additional analysis to determine what proportion of the sanctioned providers' paid claims was actually improper. We questioned the soundness of Health Services' methodology because even though the improper portion of the claim history would be potential savings, any legitimate claims submitted by the sanctioned provider could continue as a program cost for beneficiaries who would presumably receive health care services from another provider who would bill the program.

We recommended that Health Services perform cost-benefit analyses that measure the effect its antifraud activities have on reducing fraud. Additionally, it should continuously monitor the performance of these activities to ensure that they remain cost-effective.

Health Services' Action: Pending.

Health Services stated that through the use of enhanced data analysis software and relationships with its various contractors, it will develop a standard cost-benefit analysis methodology for each antifraud proposal.

Finding #4: The provider enrollment process continues to need improvement.

Health Services' Provider Enrollment Branch (enrollment branch) screens applications to ensure that the providers it enrolls are eligible to participate in the Medi-Cal program. This includes ensuring that all Medi-Cal providers have completed applications, disclosure statements, and agreements on file, to help it determine whether providers have any related financial and ownership interests that may give them the incentive to commit fraud or were previously convicted of health care fraud. It also must suspend those Medi-Cal providers whose licenses and certifications are not current or active. Although these activities are important first lines of defense in preventing fraudulent providers from participating in the Medi-Cal program, the enrollment branch is not fully performing either of these activities.

In our May 2002 report, *Department of Health Services: It Needs to Significantly Improve Its Management of the Medi-Cal Provider Enrollment Process,* Report 2001-129, we made a number of recommendations to improve the provider enrollment process. However, the enrollment branch has not fully implemented many of these recommendations. For example, we recommended that the enrollment branch use its Provider Enrollment Tracking System to ensure that it sends notifications to applicants at proper intervals. However, the enrollment branch still does not track whether it sends the required notifications to applicants, nor does it notify a provider when an application is sent to audits and investigations for secondary review.

New legislation that took effect on January 1, 2004, increases the importance of sending these notifications. If the enrollment branch does not notify applicants within 180 days of receiving their applications that their application has been denied, is incomplete, or that a secondary review is being conducted, it must grant the applicant provisional provider status for up to 12 months. Moreover, this new legislation requires these notifications for applications be received before May 1, 2003. As of September 29, 2003, the enrollment branch had 1,058 applications still open that it received before May 1, 2003. If the enrollment branch did not notify these applicants of its decision on or before January 1, 2004, it must grant them provisional provider status regardless of any ongoing review.

It is noteworthy that when the enrollment branch refers applications to audits and investigations for secondary review, the processing time typically extends well beyond 180 days. Because audits and investigations currently has about a six-month backlog, the first thing an analyst does when performing a preliminary desk review is contact the applicant to verify the current address and continued interest in applying to the program. The analyst also redoes some of the screening previously performed by the enrollment branch, such as checking to confirm that the applicant's license is valid, resulting in inefficiencies and further extending the time applicants are left waiting.

Health Services is unable to ensure that all provider applications are processed consistently and in conformity with federal and state program requirements. The enrollment branch reviews applications for certain provider types, such as physicians, pharmacies, clinical labs, suppliers of durable medical equipment, and nonemergency medical transportation. The enrollment

branch checks a variety of sources to confirm licensure, verify the information provided on the application, confirm that the applicant has not been placed on the Medicare list of excluded providers, and refers many applications to audits and investigations for further review. However, other divisions within Health Services and other departments responsible for reviewing certain types of provider applications and recommending provider enrollment do not conduct a similar review. Since different units and departments screen providers against different criteria, Health Services may be allowing ineligible individuals to participate as providers in the Medi-Cal program.

Health Services' procedures are not always effective to ensure that enrolled providers remain eligible to participate in the Medi-Cal program. Our review of 30 enrolled Medi-Cal providers that Health Services paid in fiscal year 2002–03 disclosed two with canceled licenses. Even though state law requires providers whose license, certificate, or approval has been revoked or is pending revocation to be automatically suspended from the Medi-Cal program effective on the same date the license was revoked or lost, as of August 2003, the provider numbers for both of these providers were being used to continue billing and receiving payment from the Medi-Cal program every month since the cancellations occurred. Our review of the 30 selected providers also found that, despite the fraud prevention capabilities these required disclosures and agreements provide, the enrollment branch did not always have the agreements and disclosures required by state and federal regulations. Two of the 30 provider files we reviewed did not contain disclosure statements, and Health Services could not locate agreements for 24 of these providers. The disclosure statements provide relevant information to ensure that the provider has not been convicted of a crime related to health care fraud, and that the provider does not have an incentive to commit fraud based on the financial and ownership interests disclosed. The provider agreements give Health Services a certification that the provider will abide by federal and state laws and regulations, will disclose all financial and ownership interests and criminal background, will agree to a background check and unannounced visit, and will agree not to commit fraud or abuse.

Our May 2002 audit recommended that the enrollment branch consider reenrolling all provider types. Reenrollment would improve the enrollment branch's ability to ensure that all providers have current licenses, disclosure statements, and agreements on file. Although the enrollment branch has begun

reenrolling certain provider types it has identified as high risk, it has not developed a strategy to reenroll all providers and does not have a process to periodically check the licensure of existing providers with state professional boards. Additionally, it has not completed an analysis to determine what resources it would need to reenroll all providers.

To improve the processing of provider applications, we recommended that Health Services complete its plan and related policies and procedures to process all applications or send appropriate notifications within 180 days, complete the workload analysis we recommended in our May 2002 audit report to assess the staffing needed to accommodate its application processing workload, and improve its coordination of efforts between the enrollment branch and audits and investigations to ensure that applications, as well as any appropriate notices, are processed within the timelines specified in laws and regulations.

To ensure that all provider applications are processed consistently within its divisions and branches and within other state departments, we recommended that Health Services ensure that all individual providers are subjected to the same screening process, regardless of which division within Health Services is responsible for initially processing the application. In addition, we recommended that Health Services work through the California Health and Human Services Agency to reach similar agreements with the other state departments approving Medi-Cal providers for participation in the program.

To ensure that all providers enrolled in the Medi-Cal program continue to be eligible to participate, we recommended that Health Services develop a plan for reenrolling all providers on a continuing basis; enforce laws permitting the deactivation of providers with canceled licenses or incomplete disclosures; and enforce its legal responsibility to deactivate provider numbers, such as when there is a known change of ownership. Further, we recommended that Health Services establish agreements with state professional licensing boards so that any changes in license status can be communicated to the enrollment branch for prompt updating of the Provider Master File.

Health Services' Action: Pending.

Health Services stated it has taken some steps to improve the processing of provider applications and has created a workgroup to establish a complete work plan for processing applications as required by the new legislation. It will also evaluate the internal workload study on application processing and finalize the analysis. With the addition of new staff to enhance antifraud efforts, Health Services noted that provider enrollment and audits and investigations began to develop closer working relationships, and cited various actions taken to improve communication and coordination. In addition, its programs will participate and coordinate internally, as well as with other departments, programs, and entities that perform similar enrollment functions with the aim of using consistent enrollment processing procedures. Finally, Health Services indicates that it is developing a plan to reenroll all providers, will improve its procedures to ensure that provider numbers are properly deactivated, and is working with professional licensing boards to obtain provider permit and licensing information that is timely and readily useable.

Finding #5: The pre-checkwrite process could achieve more effective results.

Health Services has a review process it calls pre-checkwrite that identifies and selects certain suspicious provider claims for further review from the weekly batch of claims approved for payment. Although the pre-checkwrite process appears effective in identifying suspicious providers, Health Services does not review all of the providers flagged as suspicious. Moreover, Health Services does not delay the payments associated with suspect provider claims pending completion of the field office review.

We reviewed 10 weekly pre-checkwrites, which identified a total of 88 providers with suspicious claims from which Health Services selected 47 for further review. At the time of our audit, 42 provider reviews had been completed, and 31, or 74 percent, of these had resulted in an administrative sanction and referral to the Investigations Branch (investigations branch) or to law enforcement agencies. According to Health Services, limited staffing precludes it from reviewing all suspicious providers. Health Services states that it must perform additional analysis to develop sufficient evidence and a basis for placing sanctions, including withholding a payment or placing utilization controls on providers.

However, when Health Services does not promptly complete its reviews and suspend payment of suspicious provider claims until it completes its on-site review, its pre-checkwrite process loses its potential effectiveness as a preventive fraud control measure. Health Services could use existing laws to suspend payments for claims that its risk assessment process identifies as potentially fraudulent or abusive and release them once a pre-checkwrite review verifies the legitimacy of the claim. Although laws generally require prompt payment, they make an exception for claims suspected of fraud or abuse and for claims that require additional evidence to establish their validity.

We recommended that Health Services consider expanding the number of suspicious providers it subjects to this process, prioritize field office reviews to focus on those claims or providers with the highest risk of abuse and fraud, and use the clean claim laws to suspend payments for suspicious claims undergoing field office review until it determines the legitimacy of the claim.

Health Services' Action: Pending.

Health Services stated that it received additional staffing in fiscal year 2003–04 to expand the number and timeliness of pre-checkwrite reviews. It also indicated it will work with its legal office to maximize the pre-checkwrite activities and develop criteria to suspend specific claims and hold checks until the review is complete.

Finding #6: Health Services and the California Department of Justice have yet to fully coordinate their investigative efforts.

Although Health Services is responsible for performing a preliminary investigation and referring all cases of suspected provider fraud to the California Department of Justice (Justice) for full investigation and prosecution, it does not refer cases as required. Moreover, Health Services and Justice have been slow in updating their agreement even though the agreement is required by federal regulations and could be structured to clarify and coordinate their roles and responsibilities and, thus, help prevent many of the communication and coordination problems we noted with the current investigations and referral processes.

Our comparison of fiscal year 2002–03 referrals of suspected provider fraud cases from Health Services' case-tracking system database to similar records from Justice's case-tracking system

database revealed that 63 (41 percent) of the 152 Health Services case referrals to Justice were late, incomplete, or never received. According to Justice, it did not include 60 of the 63 referrals in its database because they were incomplete when Justice received them or it received them close to the date of indictment by an assistant U.S. Attorney for the Eastern District of California (U.S. Attorney). For the remaining three cases, although Health Services asserts that it referred them to Justice, Health Services could not provide documentation that clearly demonstrates its referral of them. Our review of 14 investigation cases corroborated that Health Services' investigations branch referred cases to Justice late; Health Services referred 12 an average of nearly five months after the date it had evidence of suspected fraud.

Although Health Services acknowledged that referring cases to Justice after indictment by the U.S. Attorney is no longer its practice, according to the investigations branch, it investigates and refers cases to the U.S. Attorney because the U.S. Attorney indicts suspected providers and settles cases quickly. Justice, on the other hand, typically focuses on developing cases for trial to pursue sentences that it believes reflect the seriousness of the defendant's conduct. Although both approaches have merit, depending on the particular case, Health Services and Justice have not come to an agreement on when each approach is appropriate and who should make that determination.

Additionally, according to Health Services' investigations branch chief, because neither federal nor state laws provide a clear definition of what constitutes suspected fraud, the investigations branch can refer cases to Justice at varying points in the process, including before, during, or after it has met the reliable evidence standard. Admittedly, the law does not clearly define what constitutes suspected fraud, but Health Services and Justice should reach an agreement on what standard must be met to assist both agencies in coordinating their respective provider fraud investigation and prosecution efforts.

The agreement between Health Services and Justice that is required by federal regulations could help alleviate many of the current problems about when Health Services should refer cases to Justice. Over the last several years, Health Services and Justice have intermittently discussed an update of the existing 1988 agreement. However, these two entities have yet to complete negotiations for an update of this agreement or to define and coordinate their respective roles and responsibilities for investigating and prosecuting suspected cases of Medi-Cal provider fraud.

We recommended that Health Services promptly refer all cases of suspected provider fraud to Justice as required by law and that both Health Services and Justice complete their negotiations for a current agreement. The agreement should clearly communicate each agency's respective roles and responsibilities to coordinate their efforts, provide definitions of what a preliminary investigation entails and when a case of suspected provider fraud would be considered ready for referral to Justice.

To ensure that Health Services and Justice promptly complete their negotiations for a current agreement, we recommended that the Legislature consider requiring both agencies to report the status of the required agreement during budget hearings.

Health Services' Action: Pending.

Health Services stated that a draft agreement would be finalized soon. It further indicated that it clarified the need to make timely referrals to Justice in its policy and procedures.

Justice Action: Pending.

Justice stated that both agencies are working quickly and in good faith to establish an agreement that will serve to strengthen the working partnership between the two agencies.

Legislative Action: Unknown.

We are unaware of any legislative action implementing this recommendation.

Finding #7: A more effective feedback process could strengthen Health Services' antifraud efforts.

Although audits and investigations is responsible for coordinating the various antifraud activities within Health Services, its line of authority does not extend beyond audits and investigations. What is lacking is an individual or team with the responsibility and corresponding authority to ensure that worthwhile antifraud recommendations are tracked, followed up, and implemented. Such an individual or team would provide Health Services' management with information about the status of the various projects and measures that are under way, to ensure that antifraud proposals, including those involving external entities, are addressed promptly.

Without an individual or team with the responsibility and corresponding authority to follow up and act on recommendations for strengthening its antifraud efforts, some antifraud coordination issues or detected fraud control vulnerabilities may continue to go uncorrected. For example, although Health Services' provider enrollment process is the first line of defense to prevent abusive providers from entering the Medi-Cal program, the provider enrollment process continues to need improvement. Similarly, another unresolved fraud control coordination issue is the lack of an updated agreement between Health Services and Justice related to the investigation and referral of suspected provider fraud cases. Although laws make each of these state agencies responsible for certain aspects of investigating and prosecuting cases of suspected provider fraud, the current case referral practices result in a fragmented rather than a cohesive and coordinated antifraud effort. Both agencies indicate that they have made some efforts to update their 1988 agreement, but they have yet to complete negotiations for a current agreement that spells out each agency's respective roles and responsibilities.

We recommended that Health Services consider working through the California Health and Human Services Agency to establish and maintain an antifraud clearinghouse with staff dedicated to documenting and tracking information about current statewide fraud issues, proposed solutions, and ongoing projects, including assigning an individual or team with the responsibility and corresponding authority to follow up and promptly act on recommendations to strengthen Medi-Cal fraud control weaknesses.

Health Services' Action: Pending.

Health Services recognizes the contribution a clearinghouse can potentially make and will work with the California Health and Human Services Agency to more fully explore this recommendation and different approaches for its implementation.

Finding #8: Health Services needs to give proper attention to potential fraud unique to managed care.

In addition to its fee-for-service program, Health Services also provides Medi-Cal services through a managed care system. Under this system, the State pays managed care plans monthly fees, called capitation payments, to provide beneficiaries with health care services. Although fraud perpetrated by providers and beneficiaries, similar to what occurs under the fee-for-service

system, can also occur, another type of fraud unique to managed care involves the unwarranted delay in, reduction in, or denial of care to beneficiaries by a managed care plan.

Because of incomplete survey results and its concerns about the reliability of encounter data, which are records of services provided, Health Services does not have sufficient information to identify managed care contractors that do not promptly provide needed health care. In addition, Health Services does not require its managed care plans to estimate the level of improper payments within their provider networks to assure they are appropriately controlling their fraud problems and not significantly affecting the calculation of future capitated rates.

We recommended that Health Services work with its external quality review organization to determine what additional measures are needed to obtain individual scores for managed care plans in the areas of getting needed care and getting that care promptly, complete its assessment on how it can use encounter data from the managed care plans to monitor plan performance and identify areas where it should conduct more focused studies to investigate potential plan deficiencies, and consider requiring each managed care plan to estimate the level of improper payments within its Medi-Cal expenditure data.

Health Services' Action: Pending.

Health Services stated that its new contracted vendor should be able to gather data to address the inadequacies found in the surveys. It is also assessing how it can use managed care plan data to help target areas for focused monitoring. Health Services will consult internally and with outside entities on the feasibility of implementing through appropriate contract language the requirement that managed care plans estimate the level of improper payments within their Medi-Cal expenditure data.

CALIFORNIA NATIONAL GUARD

To Better Respond to State Emergencies and Disasters, It Can Improve Its Aviation Maintenance and Its Processes of Preparing for and Assessing State Missions

Audit Highlights . . .

The California National Guard (Guard) can improve its aviation maintenance and its process to prepare for and assess state missions:

- ☑ *The Army Guard's ability to perform state missions may be compromised by a shortage of qualified aircraft mechanics and delays in receiving helicopter parts.*
- ☑ *The Army Guard does not ensure that personnel readiness reports exclude ineligible troops; however, because the Office of Emergency Services typically does not request full troop strength, the Army Guard's personnel readiness has no bearing on its ability to assist the State.*
- ☑ *The Guard needs to make certain that personnel in its Joint Operations Center who coordinate the Guard's state mission response receive requisite training.*
- ☑ *The Guard does not annually review and update its various emergency plans nor ensure that it implements recommendations from past mission assessments.*

REPORT NUMBER 2001-111.2, FEBRUARY 2002

California National Guard's response as of February 2003

The Joint Legislative Audit Committee requested that the Bureau of State Audits review the California National Guard's (Guard) readiness to respond to a natural disaster, civil disturbance, armed conflict, or other emergency. However, many of the Unit Status Report (USR) records on federal readiness are not available, being classified by the U.S. Army. Similarly, the U.S. Air Force has determined that all its Status of Resources and Training System readiness data are classified. Consequently, we are unable to report on the Army Guard's or Air Guard's overall readiness ratings for their personnel, equipment on hand, equipment condition, and training. Therefore, we focused much of our audit on the missions the Guard performs at the State's request. We especially considered the three Army Guard units most frequently called up and how the percentages of grounded helicopters might affect their ability to assist in state emergencies. We also looked at how personnel readiness, as reported in the USRs, might affect use of the Army Guard for federal wartime duty.

Finding #1: A lack of staff formally trained in helicopter maintenance and delays in receiving helicopter parts may contribute to low numbers of operational aircraft.

U.S. Army regulations instruct the Army Guard commanders to attain aircraft readiness goals by effectively managing maintenance and part supplies. However, data reported in the monthly Bridge Commanders' Statements do not identify reasons for delays in the helicopters receiving either maintenance or parts—specifically, whether delays are caused by personnel levels or some other factor. In their USRs submitted between January 2000 and July 2001, two of the three units we studied reported shortages of qualified aircraft mechanics. Our review of the units' manning reports—which identify all the

units' personnel and their assigned duties and formal training—showed that 50 percent of two units' maintenance staff were not formally trained in maintenance of UH-60 helicopters. It seems reasonable to conclude that the low numbers of operational aircraft are influenced by a lack of trained aircraft mechanics.

Generally, the U.S. Army trains the Guard's aircraft maintenance mechanics but cannot accommodate all new Guard recruits in the training courses. Therefore, the Army Guard must recruit aircraft mechanics with maintenance training on other types of helicopters and provide transition training to do maintenance on its UH-60s or CH-47s. However, these mechanics may not be able to work without supervision or sign off on major maintenance items. Further, because of increased time spent training and supervising personnel without formal training, the Army Guard's qualified staff may have fewer hours to spend meeting maintenance demands.

In addition, the Army Guard indicated that a lack of replacement parts is a barrier to keeping its helicopters operational. The Army Guard attributes this to the U.S. Army's choice to not use its resources for the requisite amount of aircraft replacement parts. As a result, there are simply not enough parts in inventory to meet demand.

To help improve its percentage of operational aircraft, the Guard should improve its data tracking and collection to determine why helicopters are not operational, then take appropriate steps to correct the identified deficiencies. In addition, the Guard should reassess the feasibility of distance learning opportunities for its maintenance personnel, including those previously coordinated with the U.S. Army, until the U.S. Army makes more training slots available for new recruits.

Guard Action: Partial corrective action taken.

The Guard reports that it has taken certain actions such as forming an aviation readiness council; having its aviation directorate closely monitor monthly aircraft readiness reports to allocate resources to non-operational aircraft; and implementing a program for quick assessment of aircraft readiness, focusing on non-mission capable aircraft, their available date, and critical problems. In addition, the Guard told us that the U.S. Army is improving the availability of aircraft parts to help improve the Guard's readiness. With regard to distance learning, the Guard noted that the

necessary hardware is already available in various Guard locations and it will pursue the acquisition of distance courses when the National Guard Bureau develops them.

Finding #2: The Army Guard's use of full-time maintenance personnel to fight wildfires delays helicopter maintenance.

The Guard's practice of using its full-time helicopter maintenance staff as crew to drop water on California wildfires delays maintenance and contributes to the lack of operational helicopters. For example, in 2000, the Army Guard flew its helicopters on 13 separate fire-fighting missions between July 26 and September 5 and dropped at least 2.4 million gallons of water. We analyzed the Guard's pay records, and found that full-time maintenance facility staff from two units contributed about 65 percent of their unit's total man-days during the 2000 fire season.

The Guard should determine how frequently it uses its full-time flight facility personnel in fire-fighting missions and set a standard that will not negatively affect the Army Guard's ability to meet helicopter maintenance demands.

Guard Action: Corrective action taken.

The Guard reports that it completed an analysis of its 2000 fire fighting season payroll records for various flight personnel. The Guard stated that its data show that part-time guard personnel are engaged in its fire fighting efforts. The Guard said it has established a standard that will keep the percentage of full-time and part-time fire fighting personnel commensurate with the percentage of these same personnel at its aviation facilities.

Finding #3: Weaknesses in the Army Guard's process for reporting personnel could result in overstated personnel readiness.

Contrasted with the aviation capability for state missions, the Army Guard's personnel readiness affects only the federal need for troops. In a quarterly USR, each Army Guard unit reports its personnel status by comparing available strength levels, or staffing, against wartime requirements. However, the Army Guard lacks an effective process to ensure that a unit includes only eligible soldiers in its strength levels. For example, the three Army Guard units we reviewed erroneously included at least 21 soldiers in their

combined USRs. Therefore, these units may have overstated their personnel strength levels, or P-levels, making it appear as though they are more ready for war or other federal duties than they are.

To validate the accuracy of USR data, we expected the Army Guard's headquarters would have a process that includes at least a comparison of soldiers pending discharge and inactive soldiers to those reported in the units' USRs and a review of soldiers listed in the "nonvalidate pay report" it receives from the National Guard Bureau (NGB)—a report that identifies part-time soldiers who have not received pay for 90 consecutive days. Because the personnel office maintains such data, it could use these records to ensure that units accurately compute their P-levels. However, the personnel office does not validate the accuracy of USR personnel data for all units, so the Army Guard's headquarters cannot ensure that units are preparing their P-levels accurately.

According to the director of the personnel office, headquarters does not instruct the units, such as those in the 40th Infantry Division (40th ID) to work with the personnel office during the USR process. Consequently, the Army Guard's headquarters is relying solely on the 40th ID to accurately compute its P-levels. The 40th ID represents 52 percent of the total units the Army Guard reports to the U.S. Army and 74 percent of the Army Guard's personnel.

To strengthen its process for personnel reporting in the USR, the Army Guard should do the following:

- Instruct the 40th ID and the personnel office to work together during the USR process to ensure that units in the 40th ID report accurate personnel data.
- Train appropriate staff on how to complete the USR.
- Strengthen its USR validation procedures to ensure that units adhere to U.S. Army regulations when they report USR data.

Guard Action: Corrective action taken.

The Guard stated that is has, on two separate occasions, instructed both the 40th ID and 49th CSC, that the personnel office would validate key personnel data. In addition, in April and July 2002, the Guard trained its field command personnel on the proper procedures for completing the USR—emphasizing the problems and submission standards for non-deployable personnel. The

Guard also reported that during its April and July 2002 USR data collection and preparation, it reviewed the accuracy of personnel data using seven different personnel reports.

Finding #4: Flaws in the personnel office's database prevent the Guard from detecting all discharged soldiers units report on their USRs.

Even if the personnel office performed a more thorough review, its database contains flaws that prevent it from detecting all discharged soldiers on the USR. In our attempt to calculate the average time it takes the personnel office to process discharges, the Guard gave us two lists that we found to contain inaccurate data. First, the personnel office gave us a list of soldiers from our selected units processed for discharge in 2001. However, the Guard later informed us that six soldiers on the list were still active members of the Army Guard. Because of the errors we identified, we requested and the personnel office sent us another list. However, again we found incorrect information for some soldiers on the list, such as the Guard's officers and warrant officers. Until it corrects serious database deficiencies, the personnel office will not be able to detect all discharges that units report on their USRs.

The Army Guard should correct deficiencies in its discharge database and continually update this database to make sure that it reflects soldiers who have actually been discharged.

Guard Action: Corrective action taken.

The Guard told us that it is no longer using a secondary personnel database, which contained errors to generate its reports. It claims that the primary personnel database at its headquarters is free from deficiencies and inaccuracies and it uses this database to generate reports showing discharged soldiers.

Finding #5: Weaknesses in the Joint Operations Center's procedures may limit its ability to provide the most effective state mission response.

As part of Plans, Operations, and Security located at the Guard's state headquarters, the operations center manages the Guard's state missions. The operations center provides in-house staff training on its operating procedures and a brief overview

of the Response Information Management System, an Internet-based system used by local and state agencies to manage the State's response to disasters and emergencies. However, the operations center does not track who has attended its in-house training or require its staff to complete other disaster preparedness training. Further, the operations center's premission monitoring of potential and ongoing disasters, which allows the Guard to anticipate the general requirements of potential state missions, is not included in its Standard Operating Procedures manual (SOP manual). Because the operations center cannot ensure that all appropriate personnel have received training or are aware of standard premission activities, staff may work less efficiently and be less prepared to act during emergencies.

The Guard should do the following:

- Develop a system to continually identify requisite training for its operations center staff.
- Ensure that staff receive the requisite training in military support to civil authorities, thereby improving staff response to state missions.
- Establish and maintain a system to track the training activities that operations center staff attend.
- Include premission activities in the operations center's SOP manual.

Guard Action: Corrective action taken.

The Guard reported that Plans and Operations has developed a training chart, which is used to identify and track requisite training for staff. In addition, the director of Plans and Operations is producing a monthly newsletter to help keep staff abreast of current operations, including available training. Finally, the Guard noted that it added premission activities to its SOP manual in March 2002.

Finding #6: The Guard lacks a process to annually review and update its emergency plans.

The Guard's emergency plans guide its response to disasters such as fires, floods, and earthquakes. Although the NGB requires the Guard to review and update these plans annually by

September 30, the Guard does not have a process to ensure that this takes place. In fact, the Guard revised only 3 of its 13 plans in calendar year 2001. The director of Plans, Operations, and Security points to high staff turnover and vacancies as reasons for the delays. Without ensuring the revisions are completed, however, the Guard cannot guarantee that its plans contain up-to-date and effective responses to disasters.

The Guard should develop and implement a system to review and update its state emergency plans annually, as the NGB requires. In addition, the Guard should review all its state emergency plans by June 30, 2002.

Guard Action: Corrective action taken.

The Guard reported that it has developed a system showing the month and year it reviews and/or updates a plan and when it forwards the plan to the NGB. Moreover, the Guard told us that it reviewed all its state emergency plans and made any necessary changes as of July 2002. Further, the Guard states that it prepared and published a multi-hazard plan including annexes addressing specific hazards comparable to the plans used by the Governor's Office of Emergency Services.

Finding #7: The Guard does not have a process to implement recommendations from assessment reports.

We reviewed After Action Reports (AARs) relating to various types of large-scale state emergencies, such as the 1992 Los Angeles riots, the 1994 Northridge earthquake, and various flood and wildfire seasons. After completing each mission, the operations center performed a formal assessment of the Guard's performance and typically identified problems and made recommendations on how the Guard could improve its state mission response. Specifically, the AARs for three missions between 1996 and 1998 indicate that at the start of each mission, the Guard should work with the Office of Emergency Services to negotiate an exit strategy that includes clearly defined criteria for extracting the Guard from a mission. NGB regulations require the Guard to terminate its military support to civil authorities as soon as possible after civil authorities can handle the emergency. Without establishing an exit strategy at the start of each mission, the Guard's crews could remain active longer than necessary, performing tasks that other entities could be doing.

Also, in three AARs submitted between 1993 and 1997, we identified a recurring problem with the Guard's ability to easily track and update the status of critical equipment. However, the Guard did not implement corrective action until early 2001, nearly eight years after it first identified the problem, when the operations center developed a list of the equipment used in state missions and began tracking that equipment's availability through monthly reports other Guard directorates prepared.

Because the Guard has no formal process to address previous problems encountered during its missions, it cannot promptly implement corrective action on AAR recommendations. The Guard acknowledges it lacks an adequate system to benefit from the previous missions' lessons. It is currently conducting a study, expected to be ready by June 2002, to identify better tracking systems for all its actions and activities, including this area.

The Guard should update the operations center's SOP manual to ensure that staff establish an exit strategy at the start of each mission. In addition, the Guard should establish a process to track and implement corrective action as appropriate on AAR recommendations, ensuring quick action to correct previous mistakes. Finally, the Guard should make sure that it completes its study by June 2002 so that it can identify better tracking systems for all of its actions and activities.

Guard Action: Corrective action taken.

The Guard commented that it updated its SOP manual to include establishing an exit strategy at the start of each mission. The Guard stated that it plans to carry out its exit strategies by coordinating with the Office of Emergency Services and monitoring daily situation reports during state emergencies. The Guard stated that it also updated its SOP manual to require tracking of AAR recommendations. Finally, the Guard reported that it completed its management study in June 2002, and as of March 2003, it had purchased a computerized tracking system. The Guard expects the system to be in place and fully integrated by July 2003.

DEAF AND DISABLED TELECOMMUNICATIONS PROGRAM

Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services

REPORT NUMBER 2001-123, JULY 2002

California Public Utilities Commission's and Deaf and Disabled Telecommunications Program's responses as of August 2003

Audit Highlights . . .

Our review of the Deaf and Disabled Telecommunications Program (DDTP) concludes that:

- ☑ *Neither the DDTP nor the California Public Utilities Commission (CPUC) is fulfilling its responsibilities to ensure that telephone companies (carriers) are remitting required surcharges, possibly resulting in hundreds of thousands of dollars going uncollected.*
- ☑ *Only about 32 percent of certified carriers remitted surcharge payments over the last two years.*
- ☑ *Some of the DDTP's expenditures are for unreasonable or unnecessary items.*
- ☑ *The salaries of select DDTP employees average 24 percent higher than those of comparable state positions.*
- ☑ *Most DDTP contracts we reviewed comply with the Public Contract Code and contain adequate standards for contractors to adhere to.*

The Joint Legislative Audit Committee requested that we conduct an audit of the Deaf and Disabled Telecommunications Program (DDTP) and California Public Utilities Commission's (CPUC) accounting controls to determine whether they are sufficient to ensure the proper accounting of program revenues and expenditures. We were also asked to assess the DDTP's procedures for ensuring that its contracting practices comply with Public Contract Code and its methods for ensuring that the scope of its contracted work is sufficient, meets the needs of its customers, and is cost effective.

We determined that neither the DDTP nor the CPUC is fulfilling its responsibilities to ensure that telephone companies (carriers) are collecting and remitting required surcharges on intrastate telecommunications charges, possibly resulting in hundreds of thousands of dollars going uncollected. Moreover, the DDTP does not always further its mission when expending public funds, potentially leaving less money available for program services.

Finding #1: Neither the DDTP nor the CPUC maintain a reliable record of carriers that are providing services subject to the surcharge.

Although the DDTP and the CPUC share responsibility for ensuring that all mandated surcharges are remitted to the Deaf Equipment Acquisition Fund (DEAF) Trust, neither entity has a firm grasp on which carriers should be collecting and remitting these surcharges. As of April 2002, the CPUC's list of active carriers—or those currently certified to operate and/or provide telecommunications services in California—totaled 1,483. At least 68 percent of the carriers on the CPUC's active list did not remit surcharge revenue for 2000 or 2001. However,

the CPUC is not sure how many or which of these carriers are actively providing the intrastate services that are subject to the surcharge. Consequently, the CPUC could provide no definitive reason for why these carriers did not remit during the past two years. Some options include (1) they do not provide services subject to the surcharge, (2) they stopped operating before January 2000 or did not begin operating until after December 2001, (3) they do not collect the surcharge from their customers, or (4) they simply do not remit the surcharges they collect. No one knows for sure what the reason is. In any event, it is likely that some, if not many, of these carriers should be submitting surcharge revenue.

We recommended that the DDTP work with the CPUC to develop and maintain a reliable record of carriers that are providing services subject to the surcharge. We also recommended that the CPUC should require that all active carriers that do not submit surcharge revenues certify that they in fact do not provide services subject to the surcharge.

DDTP and CPUC Action: Partial corrective action taken.

As of January 1, 2003, CPUC staff assumed responsibility for developing and maintaining a reliable record of carriers providing services and monitoring the payment history of these carriers. The CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database, which encompasses all functions of carrier activity, including carrier reporting and carrier remittance monitoring. The database reviews bank deposits to ensure carriers' monthly reporting of their billings that are subject to surcharges as well as to determine the correct payment of surcharges by the carriers. Further, the CPUC stated it has improved its own Telecommunications Division Carrier Database, which currently has 1,758 licensed telecommunications carriers. The CPUC flagged 368 carriers as having invalid mailing addresses and will investigate these carriers for compliance with CPUC orders. The CPUC did not specifically comment on our recommendation that it should require all carriers that do not submit surcharge revenues certify that they in fact do not provide services subject to the surcharge.

Finding #2: The DDTP does not adequately review or record the payments it receives.

The DDTP is responsible for reviewing incoming transmittal forms, which detail remittances, and for maintaining an accurate record of payments so it can recognize which carriers have not remitted as frequently as required. Although the DDTP receives transmittal forms, it does little more than a cursory spot check of these forms before filing them away. In addition to not reviewing these forms adequately, the DDTP does not maintain an accurate record of payments or a payment history of carriers. As a result, it has been remiss in identifying both small and large carriers that have missed payments, potentially resulting in hundreds of thousands of dollars of uncollected funds. For example, the DDTP did not recognize that one large carrier missed submitting a payment for June 2000. As of April 2002, the carrier still had not submitted the payment, which—if similar to subsequent payments—should have been approximately $200,000. Also, because the DDTP does not maintain accurate records based on the transmittal records it receives, it is unable to investigate potential discrepancies between the information recorded on the transmittal form and that in the DEAF Trust statements provided by the Bank of America, leaving potential errors unspotted.

We recommended that the DDTP track the payment history of each carrier and monitor these records to identify delinquent carriers. Also, beginning on July 1, 2003, the CPUC will ultimately be responsible for ensuring that it collects all surcharges. Thus, the CPUC will also have to monitor payment history records to ensure that carriers are remitting surcharges as required.

CPUC Action: Corrective action taken.

In order to effectively monitor surcharges remitted by carriers, the CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database. As described in corrective action for Finding 1, this database is to assist in carrier reporting and carrier remittance monitoring. The database reviews bank deposits to ensure carriers' monthly reporting of their billings that are subject to surcharges as well as determines the correct payment of surcharges by the carriers.

Finding #3: The DDTP does not identify late payments or report them to the CPUC.

The DDTP is to send out past-due notices to carriers when they have failed to remit as required and contact the CPUC concerning all delinquent surcharges. However, the DDTP does not carry out any of these procedures. Although the CPUC has ultimate enforcement power, the DDTP neither tracks which carriers are late in submitting payments nor confirms that the carriers are remitting the appropriate late-payment penalty. As a result, large amounts of revenue in the form of late-payment penalties go uncollected, and the DDTP has missed out on thousands of dollars of revenue that could be used to provide services to the deaf and disabled communities. For example, one large carrier failed to submit surcharge remittances for September and October 2001. When it finally did so on April 2, 2002—142 and 111 days late, respectively—the carrier did not submit any late-payment penalties, which should have been almost $31,000.

We recommended that the DDTP regularly notify delinquent carriers and the CPUC of all past-due amounts. We also recommended to the CPUC that it enforce late-payment penalties.

CPUC Action: Partial corrective action taken.

The CPUC stated that it continues to endorse the enforcement of late penalties and carrier certification of nonservice. Over the past year, the CPUC developed a checklist of requirements, which are placed on each carrier and imposed by the CPUC in the carrier's grant of authority. These requirements cover, among others, whether the carrier is subject to surcharge and whether it must file a written acceptance letter. According to the CPUC, having this information allows it to evaluate its expectations against carrier performance and to take actions to revoke the authority of nonperforming carriers. After reviewing the requirements of each carrier, the CPUC relayed this information to the Administrative Law Judge Division, and communicated the compliance requirements to all carriers, allowing for carrier follow-up. Nonresponsive carriers were listed in a 30-day notice period in the CPUC's daily calendar to alert them to the potential for the CPUC to revoke their authority.

In the first eight months of 2003, 16 licensed carriers contacted the CPUC on their own volition to ask the CPUC to take back the authority it had granted to the carrier to do business in California. In addition, the CPUC revoked another 135 licenses. To do so, the CPUC identifies carriers that are nonperforming according to the requirements mentioned above. After a due process, the CPUC typically revokes the authority of these carriers. In most of these cases, these carriers are no longer in business and simply do not respond to official communications, telephone calls, etc.

Lastly, we mentioned earlier that the CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database. The vendor will also develop a program that will monitor the database for carriers that have not reported Total Intrastate Billings Subject to Surcharge for a particular month. The program will also monitor for underpayment of surcharges by carriers. A letter will be sent to the carrier to resolve each outstanding problem.

Finding #4: The CPUC could improve its oversight of the DDTP and the program.

The CPUC, despite being the governing body over the program and the DDTP, does not always demonstrate consistent oversight over the carriers or the revenue collection functions performed by the DDTP. For example, the CPUC does not ensure that carriers are following its instructions regarding the collection and remittance of surcharge revenues. Specifically, we found that carriers did not consistently apply the surcharges to the different types of intrastate service charges. In addition, carriers apply different methods when reporting and paying late-payment penalties. This may be occurring because the guidance provided by the CPUC is not detailed enough. As a result, there is a great deal of inconsistency and inefficiency in the surcharge process.

Also, the CPUC is beginning to conduct remittance review audits of various carrier practices and procedures for some of its universal service programs, but it does not do so for the DDTP. Although the DDTP claims it does unofficial "spot reviews" of transmittal forms to ensure accuracy, these reviews pale in comparison to a highly detailed remittance audit. No such formal review has taken place since 1997. Unchecked carrier practices and procedures create the potential for errors that would hamper the DDTP's ability to carry out its mission.

We recommended that the CPUC rewrite its transmittal form instructions in explicit detail, ensuring consistency among carriers. In addition, the CPUC should conduct periodic remittance audits of DDTP surcharge revenues.

CPUC Action: Partial corrective action taken.

The CPUC stated that it engages consultants and in-house staff to conduct audits of its public programs, including financial audits of the DDTP program and audits of carriers' compliance with required surcharges. The CPUC recently utilized the hiring freeze exemption process to hire two Financial Examiners to work on some of these audits. Audit fieldwork by the Financial Examiners has been completed for four small local exchange carriers, and audit results are being reviewed and reports are being prepared. A contract with the Department of Finance (DOF) to perform audits on some larger carriers beginning early this fiscal year was approved in July 2003. The DOF will focus on a mid-sized local exchange carrier, a large inter-exchange carrier, and a large wireless carrier. The CPUC did not comment on rewriting its transmittal form instructions in more explicit detail.

Finding #5: The DDTP does not always further the program's mission when expending public funds.

The DDTP sometimes spends public funds on items that are unrelated to program services or that do not further the program's mission. Specifically, the DDTP has spent excessive amounts on food for training sessions, committee meetings, and other events. In addition, many program employees have DDTP credit cards, sometimes charging imprudent expenditures such as gifts and meals. Also, the DDTP has in the past reimbursed employees for expenses typically not permitted in public service, such as moving expenses and temporary rent payments. As a result, less money is available for the individuals it serves. However, the DDTP has initiated corrective action by adopting new policies on allowable expenditures.

To ensure the prudent use of public funds in furtherance of the program's mission, we recommended that the DDTP adhere to its newly revised internal control procedures that define allowable expenses.

DDTP Action: Corrective action taken.

Assembly Bill 1734, signed into law on June 20, 2002, authorized the CPUC to enter into contract(s) for the provision of the DDTP services. In July 2003, the Department of General Services (DGS) approved a contract between the CPUC and the California Communications Access Foundation (CCAF) to provide the personnel to operate the DDTP. As a result, the DDTP no longer exists in its previous form; rather the CCAF provides services previously provided the DDTP. The DDTP implemented a new policy specifically defining allowable and nonallowable expenses.

Finding #6: The DDTP has not always reported taxable fringe benefits and needs additional controls to prevent personal use of vehicles.

Previously, the DDTP failed to report to the proper taxation authorities taxable fringe benefits received by some of its employees. These benefits include paid parking and what appears to be personal use of leased vehicles. When we informed DDTP management of this, it began to initiate corrective action, including reporting parking benefits as additional income to the employee. However, the DDTP can strengthen its internal controls to prevent or record and report employees' personal use of leased vehicles.

Thus, we recommended that the DDTP develop additional procedures to prevent personal use of DDTP-leased vehicles. For example, the DDTP should label all its vehicles and require employees to maintain daily log records of miles driven. When personal use occurs, the DDTP should report it as a taxable fringe benefit to the proper taxation authorities. We also recommended that the DDTP follow its new procedures to report parking fringe benefits as taxable income on employees' W-2 forms.

DDTP Action: Corrective action taken.

As stated earlier, the DDTP no longer exists in its previous form; rather the CCAF provides services previously provided the DDTP. The DDTP's payroll service reported to the employee and the proper taxation authorities the taxable amount of any parking benefits per IRS rules. Also, the DDTP developed and implemented mileage logs, employees had

begun to log miles driven and locations visited on a daily basis, and supervisors verified the mileage driven. Finally, the DDTP also ordered decals for its leased vehicles, which state, "For Official Use Only," along with the DDTP logo.

Finding #7: Some DDTP contracts lack adequate benchmarks or standards to measure contractor performance.

Some of the contracts that we tested lacked specific performance standards for contractors as well as provisions for monetary penalties for nonperformance. The fact that the DDTP has expressed some dissatisfaction with some of the services provided exacerbates this problem. Had the DDTP established appropriate service levels, performance measures, and provisions to collect for noncompliance in the original contract, the vendors might have performed at acceptable levels or the DDTP might have collected penalties for their failure to do so.

We recommended that the DDTP ensure that all future contracts have established performance standards as well as provisions to collect damages from nonperforming contractors. Also, the program's administration will undergo some changes over the next year, including the CPUC potentially contracting out for many of the services the DDTP currently provides. Whether the CPUC contracts out for all or some of the day-to-day provision of program services, it should include specific provisions in its contracts that require contractors to comply with state laws, regulations, and policies related to reimbursable expenses. In addition, it should include specific performance standards in its contracts and monitor whether the contractors are meeting those standards. Finally, the CPUC should include provisions in its contracts that will allow it to collect damages from nonperforming contractors.

DDTP and CPUC Action: Partial corrective action taken.

Assembly Bill 1734, signed into law on June 20, 2002, authorized the CPUC to enter into contract(s) for the provision of the DDTP services. The CPUC reported that it conducted a competitive bidding process to contract for the personnel to operate the DDTP. The CPUC reported that its competitive bidding process and subsequent contract adhered to all required state contracting rules including requirements related to reimbursable expenses. According to

the CPUC, its contract with the CCAF includes performance measures to be met by CCAF and penalties for noncompliance. The CPUC also stated that it holds all contracts providing services or goods for the DDTP. Program contracts that existed prior to July 1, 2003, have been or are currently being transitioned to state contracts. The transition of these contracts includes submission for review and approval by DGS. The CPUC said that all future program contracts will also be submitted for DGS review and approval.

PUBLIC UTILITIES COMMISSION

Investigations of Improper Activities by State Employees, February 2003 Through June 2003

ALLEGATION I2002-753 (REPORT NUMBER I2003-2), SEPTEMBER 2003

Public Utilities Commission response as of September 2003

Investigative Highlights . . .

A supervisor with the Public Utilities Commission (PUC):

- ☑ *Improperly deposited into his personal bank account $80,759 he received from PUC-sponsored conferences he oversaw during 1999, 2000, and 2001.*
- ☑ *Achieved a profit of $37,542 after paying conference expenses.*
- ☑ *Used $1,408 in funds he received during the 1999 conference to pay for alcohol.*

We investigated and substantiated that a supervisor with the Public Utilities Commission (PUC) improperly deposited into his personal bank account funds he received from the annual state railroad conference (conference) he oversaw.

Finding #1: The supervisor improperly deposited conference funds into his personal bank account.

In violation of state law, the supervisor improperly deposited into his personal bank account at least $80,759 he received as a result of his involvement with the conference. Specifically, between June and August 1999, he deposited $30,056 in checks he received from various individuals or groups of individuals who attended that year's conference. Between May and August 2000, the supervisor deposited into his personal account $8,835, representing a $95 registration fee for as many as 93 individuals. The following year, between July and October 2001, the supervisor deposited $41,868 in his personal account, most of which related to $200 registration fees for more than 130 attendees.

The supervisor maintained that the conference was not a state-sponsored function but rather a joint effort involving various representatives from government, railroad companies, and consulting firms. He reasoned that the State paid only for registration and per diem costs for state-employed attendees and that no one, including his supervisors, indicated that he was handling conference funds inappropriately. Nonetheless, the decision to manage these funds outside the State Treasury is not consistent with state law. The law characterizes funds as public

funds when employees receive them in their official capacity. Documentation such as conference announcements, registration forms, hotel contracts, and check copies clearly demonstrate that these events were advertised as a state conference that the PUC endorsed and that the supervisor acted in his official capacity with the State when he accepted payments related to the conference.

Finding #2: The supervisor profited from his involvement with the state conference.

Because the PUC allowed the supervisor to control conference funds outside of approved state accounts, he was able to retain as much as $37,542 in profits. State law prohibits state employees from engaging in any employment, activity, or enterprise that is clearly inconsistent, incompatible, in conflict with, or inimical to their duties as state officers or employees. Incompatible activities include using state time, facilities, equipment, supplies, and the prestige or influence of the State for one's own private gain or advantage. Our analysis indicates that the supervisor profited by at least $3,725 from the 1999 conference; $3,386 from the 2000 conference; and $30,431 from the 2001 conference.

We asked the supervisor to review our calculations and provide any additional evidence, particularly concerning any conference-related costs that might demonstrate he had not profited from these events. The supervisor insisted that he had lost money each year on the conference and that he had maintained detailed accounting records that proved this until one of his superiors told him that he no longer needed to keep them. After reviewing the accounting records and invoices we obtained from each of the facilities that hosted the conferences, the supervisor stated that he had paid other costs, such as off-site dinners and mailing expenses, that these bills did not reflect. However, he was unable to provide documentation to support any of these additional costs.

Finding #3: The supervisor used funds to pay for alcohol-related expenses.

Of the money the supervisor received and paid for costs associated with the 1999 conference, we identified $1,408 that pertained to alcohol-related expenses. State law prohibits state officers and employees from using state resources for personal enjoyment, private gain, or personal advantage or for an

outside endeavor not related to state business. As we mentioned previously, because state law characterizes the conference funds the supervisor received and deposited as public money, its use to purchase alcohol constitutes a misuse of public funds.

PUC Action: Partial corrective action taken.

The PUC discontinued the conference and plans to train all staff who may accept money from outside parties on proper record-keeping procedures and fiscal accountability. In addition, the PUC states it does not plan to initiate personnel action against the supervisor until it receives and completes its review of critical documentation.

CALIFORNIA PUBLIC UTILITIES COMMISSION

State Law and Regulations Establish Firm Deadlines for Only a Small Number of Its Proceedings

Audit Highlights . . .

Our review of whether the California Public Utilities Commission (commission) promptly resolves formal and informal proceedings found the following:

- ☑ *Few of the 1,602 formal proceedings the commission initiated between January 1, 2000, and June 30, 2003, were subject to statutory deadlines.*
- ☑ *Commission staff provided various reasons for delays, including that the outcomes of some proceedings were dependent on other decisions or investigations or the proceedings were purposely kept open to take up related issues or to manage them in multiple phases.*
- ☑ *Two factors contributed to delays in processing the more informal advice letters, which the commission uses to approve minor requests from utilities: Some had a lower workload priority and some required formal resolution or investigation.*

continued on next page

REPORT NUMBER 2003-103, NOVEMBER 2003

California Public Utilities Commission's response as of November 2003

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether the California Public Utilities Commission (commission) promptly completes the various types of administrative proceedings it is responsible for conducting. The audit committee asked that we determine how the commission sets priorities in the water, telecommunications, and energy areas when conducting its various types of administrative proceedings. Additionally, we were asked to review staffing levels to assess whether these levels are adequate for the commission to comply with its statutory mandates regarding administrative proceedings. As part of the assessment, we were to consider other studies that may have been performed related to staffing. Finally, the audit committee requested that we identify any timelines contained in law or regulations for the completion of proceedings. We were asked to select a sample of proceedings that exceeded the timelines yet remain unresolved and another sample that exceeded the timelines but were resolved and determine the reasons for delays.

Finding #1: Some proceedings the commission closed promptly that it later reopened appeared to be delayed.

The commission resolved five of 45 proceedings we reviewed within the statutory deadline or guideline, but because its tracking system does not appropriately reflect the resolution of proceedings that are reopened, these proceedings appeared to have been delayed. The commission's system tracks numerous pieces of information about each proceeding, including the title and type of proceeding, when it was opened and closed, and when it was reopened. However, when the commission

Although the commission cited workload and inadequate staffing as contributing to delays in processing its formal proceedings and advice letters, the lack of a workload tracking system hinders its ability to justify staffing needs.

reopens a proceeding, such as when it considers requests for a rehearing, and then closes the proceeding again, the later closing date replaces the initial one. Because only the later closing date is used in measuring how long the commission took to resolve the proceeding, the commission appears to have required more time than it actually did. When we became aware that the closing dates in the tracking system were not always accurate, we reviewed all 70 of the proceedings that had reopen dates and found that the commission resolved 43 within the original deadlines.

We recommended that the commission modify its tracking system to retain the original closing date as well as record its subsequent closing date for those proceedings it reopens.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission believes that our report fails to contemplate the perhaps significant cost of either enhancing or replacing the tracking system. However, based on discussions with our information technology staff, we do not believe the cost to modify the commission's tracking system to retain the original closing date and subsequent closing date for reopened proceedings would be significant. Further, since the commission acknowledges that it does not know whether the costs to enhance or replace its tracking system would be significant, it should first determine what those costs are. If they are prohibitive, the commission should manually track the original closing dates of all proceedings it reopens.

Finding #2: The commission did not report certain proceedings.

Although the commission tracks and reports to the Legislature whether it has met certain deadlines established in law, it does not report whether it is meeting the 60- and 90-day deadlines for issuing draft decisions. Moreover, it does not adequately track the submission date that would allow it to do so. Specifically, although commission staff provided us with submission dates for rate-setting and quasi-legislative proceedings, two of the 12 submission dates reviewed for accuracy were erroneous. In addition, the commission initially was unable to provide us with submission dates for adjudicatory proceedings. According to

the chief administrative law judge (ALJ), the commission based its decision to report only certain deadlines to the Legislature on its belief that the Legislature is most concerned with the portion of these proceedings involving commissioners' actions; therefore, it tracks and reports whether the commissioners have met the 60-day deadline to approve final decisions. However, because ALJs are most often responsible for meeting the 60- and 90-day deadlines to prepare draft decisions, the commission's decision not to report compliance with these deadlines to the Legislature overlooks the portion of the proceedings subject to these deadlines. Therefore, because state law requires the commission to issue draft decisions within either 60 or 90 days of submission, we believe it is important to accurately track all submission dates in order to monitor compliance with these requirements.

To ensure it is complying with the 60- and 90-day deadlines between submission date and filing a draft decision, we recommended that the commission better track its submission dates and monitor whether it is meeting its deadlines.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

Finding #3: The commission did not prepare a work plan access guide annually as required by law.

Although state law requires that the commission develop, publish, and annually update a work plan access guide (work plan), it did not prepare the work plan for 2000 through 2002. Among other things, state law requires the commission to include within the work plan a description of the scheduled rate-making proceedings and other decisions it may consider during the calendar year, information on how the public and ratepayers can gain access to the commission's rate-making process, and information regarding the specific matters to be decided. Ultimately, the commission did prepare a work plan for 2003 that included its criteria for determining regulatory priorities and a list of the 2003 major proceedings. The commission states in its 2003 work plan that it allocates its staff resources for decision making according to a stated set of priorities established by its president.

To ensure it discloses to the public and the Legislature its process for prioritizing its proceedings, we recommended that the commission continue to annually prepare and publicize a work plan, which includes its criteria for prioritizing formal proceedings, as required by law.

Commission Action: Corrective action taken.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

Finding #4: The commission delayed closing or failed to close advice letters promptly.

Staff promptly reviewed and approved 17 of the telecommunications division's and 10 of the energy division's advice letters, which the commission uses to address minor requests from utilities. However, staff either delayed closing or failed to close these 27 advice letters in the proposal and advice letter (PAL) tracking system. This represents 30 percent of the 90 advice letters we selected for testing. We believe that the high proportion of advice letters in our sample that remain open according to the dates in the PAL tracking system when they are actually closed should be of concern to the commission because it recently began using data recorded in the PAL tracking system to report to the commissioners on the status of advice letters. This type of erroneous data generated by the tracking system could be misleading to the commission and to those to which the commission reports this information.

We recommended that to ensure the information included in the PAL tracking system is accurate for reporting to the commissioners in public meetings on the timeliness of advice letters, the commission should review all advice letters in the system and close those where it is appropriate to do so.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission believes that our report fails to contemplate the perhaps significant cost of either enhancing or replacing the PAL tracking system. However, the commission's response mischaracterized

this issue because our recommendation does not require the commission to enhance or replace the PAL tracking system, but to correct the data generated by it.

Finding #5: The telecommunications division does not adequately maintain and track its advice letters.

The commission's telecommunications division (telecommunications) lacks a filing system that allows it to store advice letters and the supporting documentation for the letters in a central location. Thus, telecommunications had difficulties locating advice letter files and related supporting documents. Specifically, telecommunications staff required several weeks to locate 60 advice letter files we requested and were ultimately unable to locate six of them. We observed in many instances that advice letters were located at an analyst's desk or piled on tables rather than in a central filing area. Telecommunications staff conceded that maintaining and tracking advice letters has been and continues to be a problem.

In an attempt to address its filing problems, telecommunications has initiated a pilot project that allows utilities to submit advice letters and supporting documents in an electronic format. A program manager indicated that telecommunications intends to maintain electronic copies of the advice letter and supporting documents, which he believes will facilitate their storage and tracking. Although this may eventually prove successful, telecommunications still needs to file and track the advice letters and supporting documents of utilities that currently choose not to file electronically in such a way that it is able to accurately and promptly retrieve them.

Finally, as part of its processing, telecommunications requires utilities to submit a summary sheet with their advice letters. Telecommunications uses this summary sheet to track the advice letter's progress by indicating the differing levels of review and approval it has received. However, staff often could not locate the relevant summary sheet or, when found, it was not fully completed.

We recommended that as part of its new electronic filing process, the commission ensure that the telecommunications division creates an effective centralized filing system for those advice letters and supporting documents not submitted in electronic format. Additionally, for purposes of oversight and

external and internal review, the commission should ensure that telecommunications staff consistently complete and retain summary sheets to evidence appropriate approval and review and that telecommunications maintains the summary sheets in its advice letter files.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

Finding #6: The commission lacks a workload tracking system that would allow it to justify its staffing needs.

Although the commission indicated that staffing is a limiting factor in promptly processing its formal proceedings and advice letters, it was unable to provide us with workload analyses to support these contentions. In fact, the Department of Finance (Finance), in various reports and management letters it prepared between February 1998 and February 2003, reported that the commission lacks a workload tracking system that would allow it to justify its staffing needs. In response to a February 2003 management letter, the commission began to revise its workload tracking system to address Finance's concerns; however, it does not anticipate implementing key phases of the new system until the end of 2003 or the beginning of 2004. Thus, during our audit the commission was unable to provide us any staffing analyses that would allow us to determine whether its staffing levels are adequate to promptly process formal proceedings and advice letters.

We recommended that the commission continue to work with Finance on improving its workload tracking system so that it can justify its staffing needs.

Commission Action: Pending.

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission indicated that if we could not perform a quantitative analysis of the commission's staffing levels, then we might have performed some qualitative analysis. The commission further stated that we could have interviewed commission management

to see what activities or projects they believed should be undertaken but are prevented by inadequate staffing levels. Contrary to the commission's response, however, we met with the commission's management staff on several occasions. During these meetings, management staff asserted that workload and inadequate staffing contributed to delays. However, as we stated in our report, while the commission's management staff asserted they were short of staff, they could not provide evidence to support their claims.

CONTRACTORS STATE LICENSE BOARD

Investigations of Improper Activities by State Employees, July 2001 Through February 2002

ALLEGATION I2000-753 (REPORT I2002-1), JUNE 2002

State and Consumer Services Agency's response as of March 2002[1]

Investigative Highlights . . .

A Contractors State License Board (CSLB) executive engaged in the following improper governmental activities:

- ☑ *Accepted $4,000 from a non-state entity for performing duties related to his state function.*
- ☑ *Circumvented civil service hiring practices by directing a CSLB contractor to pay an employee to work for the CSLB.*

CSLB:

- ☑ *Made an emergency and subsequent permanent appointment of an employee that were illegal.*
- ☑ *Made other questionable or improper appointments of additional employees.*

Along with the Department of Consumer Affairs (Consumer Affairs), which oversees the Contractors State License Board (CSLB), we investigated and substantiated allegations that an executive at the CSLB engaged in activities that were incompatible with his state position when he accepted payment from a non-state entity for serving on an advisory panel as part of his state duties. The same executive circumvented civil service hiring policies, did not disclose pertinent facts about a collision he had in a state vehicle, and made inconsistent statements to internal affairs investigators. Specifically, we found:

Finding #1: The executive engaged in incompatible activities.

In violation of state law, the executive accepted $4,000 from a non-state entity for serving on an advisory panel that was related to his state duties. The non-state entity selected the executive to be a member of its consumer advisory panel (advisory panel). The CSLB members were aware of and condoned the executive's participation in the advisory panel.[2] In addition, the executive told us that both he and the board members believed his participation was congruent with his duties at the CSLB.

[1] Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2003, this is the date of the auditee's latest response.

[2] The CSLB has a 15-member board, appointed by the governor and the Legislature. The board appoints the CSLB executive officer and directs administrative policy.

After the non-state entity selected the executive to be part of the advisory panel for a two-year term, the executive participated in 14 separate events—10 meetings, 2 facility tours, a breakfast social, and a reception. The non-state entity paid the executive a total stipend of $4,000, or $400 for each of the 10 meetings he attended. The executive's two-year term on the advisory panel ended in December 2000.[3] The executive violated state law by accepting payment from an entity other than the State for the performance of his state duties.

Finding #2: The executive intentionally circumvented civil service hiring practices.

Consumer Affairs concluded that the executive created a situation that would have allowed a CSLB contractor to "launder state contract funds." The executive did this by directing a contractor to pay an employee, employee A, to work for the CSLB during November and December 1997, rather than following standard civil service procedures for the position. However, although Consumer Affairs concluded that the executive created this situation, it appears the laundering of state contract funds did not occur, because the contractor told us the CSLB did not reimburse it for the amounts it paid employee A.

Finding #3: The CSLB made illegal emergency and permanent appointments of employee A.

Although the contractor paid employee A only for work during November and December 1997, employee A continued to perform work for the CSLB during 1998 and 1999 under emergency and permanent appointments that the State Personnel Board (personnel board) ultimately determined to be illegal.

On February 2, 1998, the CSLB sent a memorandum to Consumer Affairs requesting that it make an emergency appointment of employee A to a Career Executive Assignment (CEA) position, retroactive to January 1, 1998.[4] According to the personnel board,

[3] The executive left the CSLB and began working for another state agency effective August 14, 2000. According to a board member, since the last advisory panel meeting of the executive's two-year term would be in October, they wanted him to complete his service.

[4] State law defines a Career Executive Assignment as an appointment to a high administrative and policy-influencing position within the state civil service in which the incumbent's primary responsibility is the managing of a major function or the rendering of management advice to top-level administrative authority.

Consumer Affairs approved the appointment, though its reason for doing so is unclear. Clearly, the employee already had been working for the CSLB without any formal agreement or approval.

State law allows departments to make emergency appointments under certain circumstances, including preventing the stoppage of public business when an actual emergency arises. According to the personnel board, emergency appointments provide flexibility for responding to staffing needs that are so urgent, unusual, or short term that they cannot reasonably be met through other civil service appointment procedures. In March 1999, the personnel board concluded that there was nothing unusual or of an emergency nature that required the filling of a CEA position with an emergency appointment. In fact, it found that the record reflected that the CSLB was deliberately avoiding the competitive employment process.

On March 23, 1998, the CSLB announced an examination for the permanent CEA position. Nine candidates, including employee A, applied for the position. The CSLB reported that on April 1, 1998, a two-person evaluation panel that included the executive screened the applications based on detailed rating criteria. No interviews were held. The CSLB permanently appointed employee A to the position on the same day as the evaluation. The personnel board determined that the permanent appointment was illegal because the position never was established through the required process; preselection of employee A was evident; and the examination was a spurious process intended to give the appearance of a competitive examination.

The personnel board canceled employee A's illegal appointments, both the emergency and permanent appointment. Employee A, with the support of the CSLB, appealed the decision, and the personnel board ultimately overturned the cancellation of the emergency appointment because more than one year had passed between the appointment and the personnel board's attempt to cancel it. State law permits the personnel board to declare an appointment void from the beginning if such action is taken within one year after the appointment when an appointment was made and accepted in good faith but was unlawful. The cancellation of the permanent appointment was not overturned. Because it found no evidence that employee A had acted in other than good faith when he accepted the appointments, the personnel board allowed employee A to retain the $75,485 in compensation he earned from January 1998 through March 1999.

Finding #4: The CSLB made other questionable or improper appointments.

On April 13, 1999, the personnel board notified the CSLB that, in light of its recent findings regarding the processes the CSLB used to select and appoint individuals for CEA positions, it was revoking the CSLB's authority to conduct examinations for these assignments. State law gives the personnel board's executive officer the authority to delegate selection activities to an appointing power. When the personnel board has substantial concerns regarding a department's capability in this regard, it can require that it preapprove or be involved with all aspects of the examination process.

Agency Action: Pending.

The State and Consumer Services Agency (agency), which oversees Consumer Affairs, plans to provide briefings to key departmental managers on compliance with ethical standards and to determine other appropriate actions that could be taken to prevent a recurrence of this type of behavior. In addition, the agency secretary has asked for a review to determine whether further actions should be taken against the subject employee, even though the employee has retired from state service.

CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

Investigations of Improper Activities by State Employees, February 2003 Through June 2003

ALLEGATION I2002-661 (REPORT I2003-2), SEPTEMBER 2003

California Unemployment Insurance Appeals Board's response as of September 2003

Investigative Highlights . . .

The California Unemployment Insurance Appeals Board engaged in the following improper governmental activities:

- ☑ *Improperly granted leave valued at an estimated $170,314 to 314 of its nonexempt employees who it already compensated for their overtime.*
- ☑ *Failed to maintain accurate time and attendance records for each employee.*

We investigated and substantiated an allegation involving the California Unemployment Insurance Appeals Board (Appeals Board) improperly granting unofficial time off to employees even though it had already compensated them for the overtime they worked.

Finding: The Appeals Board improperly granted leave that resulted in economic waste.

The Appeals Board improperly granted four days of leave to most of its employees. The Appeals Board employs 517 employees, consisting of both exempt and nonexempt employees. Exempt employees who work time in excess of the minimum average workweek shall not be compensated in overtime or compensatory leave. In contrast, the Appeals Board can either pay or award leave to nonexempt employees for overtime worked. In October 2001, the Appeals Board and the bargaining unit representing the Appeals Board's administrative law judges (who are exempt employees) entered into an agreement to grant these employees one day off each quarter in 2002 in exchange for an increased workload.

The Appeals Board has some flexibility in granting informal leave to exempt employees who work substantial overtime, but the same flexibility may not extend to granting leave to nonexempt employees. Nevertheless, the Appeals Board decided to also grant four days of informal administrative leave to its 314 nonexempt employees, even though it had already compensated those employees for overtime worked, resulting in an economic loss to the State. We could not determine the exact loss to the State since

the Appeals Board does not use the State Controller's Office's leave accounting system nor does it have a formal method to track the leave it grants to its employees. However, the leave improperly granted to 314 nonexempt employees totaled an estimated $170,314. The Appeals Board also violated state regulations when it failed to keep complete and accurate time and attendance for each employee.

Agency Action: Partial corrective action taken.

➲ The California Labor and Workforce Development Agency (agency), to whom the Appeals Board reports, disagreed with our conclusion that the Appeals Board improperly granted leave. The agency argued that Government Code, Section 19991.10, provides departments broad discretion to grant administrative time off as part of the appointing power's basic authority to manage its departments and that the statute sets forth no standards or criteria and provides no limitations upon the granting of such leave, except that no paid leave shall exceed five working days without prior approval of the Department of Personnel Administration (Personnel Administration). The agency also pointed out that the State Personnel Board (SPB) defined administrative time off as paid time granted by an appointing power to employees for the good of the service, to promote morale, and for other good reasons. However, the agency failed to note that the SPB also provided examples of the specific types of situations where administrative time off has been granted, such as when the appointing power determines that the safety of the employees is better served by their remaining at home or when work facilities have been destroyed or rendered uninhabitable because of lack of heat or electricity. Current state regulations related to Government Code, Section 19991.10, support the SPB's interpretation in that the regulations allow appointing powers to grant such employees administrative time off in emergency situations, but do not provide additional guidance on how the discretion provided by Section 19991.10 of the Government Code may be exercised. Thus, the Appeals Board's use of administrative leave in this case does not appear to be consistent with the intent of state law and regulations. We also believe that the Appeals Board's decision to grant administrative leave to those employees who it already compensated for overtime is wasteful and duplicative.

Notwithstanding, the agency said that it has asked Personnel Administration to review and provide written clarification on the matter and that it would instruct the Appeals Board to abide by any instructions Personnel Administration provides. With regard to our conclusion that the Appeals Board failed to track its employees' use of the administrative leave, the agency reported that it believed there was an internal misunderstanding surrounding the recording of administrative leave granted because the Appeals Board did not provide its employees with clear directions on how to record such leave. As a result, the agency directed the Appeals Board to develop a formal policy for the reporting of such absences.

CALIFORNIA VETERANS BOARD

Without a Clear Understanding of the Extent of Its Authority, the Board Has Not Created Sufficient Policies Nor Provided Effective Oversight to the Department of Veterans Affairs

Audit Highlights . . .

Our review of the California Veterans Board (board) revealed that:

- ☑ *The board has not established itself as an effective policy-maker for the Department of Veterans Affairs (department).*
- ☑ *The board lacks the independent counsel to minimize the legal risks of its policy-making and appeals actions.*
- ☑ *The board's appeal process needs to ensure that veterans' appeals are handled consistently and appropriately.*
- ☑ *The board's effectiveness is hindered by its reduced membership and lack of training on its responsibilities.*

Although the department has implemented eight of the 14 recommendations that were reviewed from our previous audits, it has not given sufficient attention to a key recommendation regarding the long-term viability of the Cal-Vet program.

REPORT NUMBER 2002-120, JUNE 2003

California Veterans Board's response as of January 2004 and the Department of Veterans Affairs' response as of February 2004

The Joint Legislative Audit Committee (audit committee) requested that we review the California Veterans Board's (board) oversight of the Department of Veterans Affairs (department). Specifically, the audit committee was concerned that the board may not always exercise independent oversight and guidance of the department in a manner that would further the department's mission and goals. Additionally, the audit committee wanted to know the effectiveness of corrective actions the department has taken on our recommendations from previous audits.

Finding #1: The board is not an effective policy-maker for the department.

Although state law gives the board considerable policy-making authority over the department, the board of seven volunteers has established itself as an ineffective policy-maker, unable to strengthen weaknesses in the department's administration of veterans' programs that the Bureau of State Audits (bureau) has reported over the past three years. As an example of the board's inability to effect strong policy, only half of its 32 policies provide direction for departmental operations. Further, although the bureau and other oversight agencies have identified a number of problems within the department, the board has no clearly defined policies to guide and monitor the department's corrective actions. The board has also not used the services of the inspector general for veterans affairs (inspector general) to review the department's operations in areas where board policy could improve the department's delivery of services to veterans.

We recommended that the board assert its policy-making authority by actively identifying areas of the department's operations that it feels need guidance or direction and developing meaningful policies that provide the department with the guiding principles necessary to complete its mission. Using the issues raised in our previous audits and by the inspector general would be a good start for the development of specific policies.

We also recommended that the board monitor the department's corrective actions on external audits by establishing a policy requiring the department to regularly report its progress in implementing corrective actions and when needed, create policies to guide the department's corrective actions.

Board Action: Partial corrective action taken.

The board states that it is currently developing a board training manual and researching training programs that will encompass policy-making guidelines. The board believes that these training efforts, along with the assistance of independent counsel, will allow it to develop meaningful policies to provide the department with guiding principles. In addition, the board realizes that the corrective actions from external audits will provide direction for the department's goals and objectives. The board has been working with the department to obtain funding for independent counsel. However, on February 2, 2004, the interim secretary for veterans' affairs declined the board's request for independent counsel, indicating to the board that balanced against the difficult fiscal challenges that all Californians now face, it is his position that the department's attorneys are providing legal advice, counsel on appeals, and aid to the board in a legally acceptable manner consistent with the law and free of conflicts.

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Finding #2: The board has no independent counsel to provide legal advice on its responsibilities.

Despite the board's important responsibilities for making policy and ruling on veterans' appeals of services that the department has denied, the board does not have an independent counsel it requires to minimize the legal risks of its actions. Instead, the board relies on the department's legal staff for advice. Although they are probably knowledgeable on these laws, the department's legal staff are not the appropriate advisors for the board on policies

under consideration because the board's policies govern the department. Further, the board's rulings on veterans' appeals should have an independent and fair consideration of the department's actions and the veterans' rights to services. Currently, the board must rely on the department's legal staff for advice on appeals, a practice that introduces questions of fairness and impartiality on appeal decisions.

We recommended that to improve the board's ability to independently make decisions on policies and appeals, and to reduce the legal risk created by its present practices, the board should establish a policy to obtain the services of an independent counsel to assist with its policy-making and appeal responsibilities.

Board Action: Partial corrective action taken.

The board indicates that it passed a policy citing the need for independent counsel on July 18, 2003, and that as of January 2004 a retired attorney sits on its select committee on policies and procedures. However, as noted previously, on February 2, 2004, the interim secretary for veterans' affairs declined the board's request for independent counsel.

Finding #3: The board lacks formal written procedures for conducting appeals in a fair and consistent manner.

Despite the board's existence since 1946, it has no formal written procedures outlining or detailing instructions for processing appeals at an operational level. Further, the board does not have a clear understanding of the type of appeal procedures it should follow, which could result in the board conducting a more formal hearing on an appeal than is warranted or not giving veterans an adequate degree of protection. Without a set of formalized procedures, the board cannot ensure that its members have the same understanding of how to conduct appeals, nor can it be certain that members' actions are consistent. However, to give veterans the fair treatment they deserve and expect, and to avoid legal risks, the board must be able to process all veterans' appeals consistently and professionally. In addition, the board relies upon the department's chief counsel to preside over formal hearings on appeals. However, as a member of the department's management team and potentially a participant in the decisions to deny services, the chief counsel is not in a position to act in an unbiased manner.

To ensure that the board consistently and fairly reviews veterans' appeals of services that the department has denied, we recommended that the board should create a policy establishing formal written procedures for conducting appeals. In addition, to ensure that every veteran's appeal is heard in the proper forum, the board should acquire the expertise to determine the appropriate type of hearing for each appeal. In addition, to avoid the appearance of bias in its appeal decisions, the board should discontinue having the department's chief counsel preside over formal hearings.

Board Action: Partial corrective action taken.

The board states that it is currently developing a training manual that will include specific steps for reviewing and conducting appeals. Further, to avoid the appearance of partiality in the appeal process, the board was working with the department to obtain the services of independent counsel. However, as noted previously, on February 2, 2004, the interim secretary for veterans' affairs declined the board's request for independent counsel.

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Finding #4: With a reduced membership, the board may lack the expertise the Legislature intended and may be unable to hold meetings.

The board's effectiveness has been hindered over the past few years because is has rarely comprised the seven members authorized by the Military and Veterans Code. The governor appoints board members and five board members must have expertise in a particular area required by law. Without these expert members, the board might be limited in its understanding of departmental issues and veterans' appeals. Additionally, its reduced membership could prevent it from meeting the quorum of four required by board policy to conduct business.

To assist the governor in promptly appointing members to fill both the current and future vacancies, we recommended that the board proactively identify possible board members when vacancies occur.

Board Action: Pending.

The board states that there are three vacancies on the board as of January 15, 2004 and it is waiting for the Governor to appoint new members. It currently receives calls from veterans interested in joining the board, and redirects those veterans to the Governor's appointment office.

Finding #5: To be an effective oversight and policy-making body, the board needs to adequately train its members.

Contributing to the board's deficiencies as a policy-making and oversight body is the fact that members receive no formal training regarding the laws and regulations controlling veterans' affairs; board policies, duties, and authority, including how to conduct appeals; departmental operations; state laws regarding open meetings; and state laws regarding the privacy of medical information. Insufficient training may have caused the board to violate state open-meeting laws and possibly resulted in two instances of the board discussing veterans' confidential medical records in public board sessions.

To enable board members to perform their oversight functions effectively, we recommended that the board provide ongoing training to its members in topics related to their responsibilities.

Board Action: Partial corrective action taken.

The board states that it is currently developing a training manual that will include areas on policy making, duties and authority, the appeal process, department operations, state laws regarding open meetings, and state laws regarding the privacy of medical information. However, at this time the board can only send board members to ethics training due to budget constraints.

Finding #6: Despite implementing many recommendations we made in previous audits, the department has not sufficiently addressed an important issue for the Cal-Vet program.

The board's weak policy-making deprives a problem-prone department of needed assistance in improving on weaknesses documented in reviews by the bureau and other oversight agencies.

Our follow-up on recommendations we made to the department in two previous audits revealed that the department has implemented eight of the 14 recommendations we could reasonably expect the board to address. However, the department has not given sufficient attention to a key recommendation regarding the long-term viability of the Cal-Vet program, the department's loan program that helps veterans purchase farms or homes. As mentioned in our previous audits, unless there is a change in federal tax laws, fewer and fewer veterans will benefit from the Cal-Vet program because federal tax restrictions have limited eligibility for loans backed by the bonds that supply the majority of the program's funding. Despite two previous unsuccessful efforts, the department is attempting to change federal tax laws to make more veterans eligible for the Cal-Vet program. However, the department has not performed sufficient contingency planning for the potential reduction in the Cal-Vet program's funding should its efforts fail again.

To ensure effective and efficient operations, the department should continue to address the recommendation of our prior audits, especially the recommendations regarding the long-term viability of the Cal-Vet program.

Department Action: Pending.

Although we anticipated that the department would respond to this finding, the board submitted a response to us. The board indicates that it will continue to address the bureau's concerns regarding the Cal-Vet program once it obtains independent counsel.

VETERANS HOME OF CALIFORNIA, YOUNTVILLE

Investigations of Improper Activities by State Employees, March 2002 Through July 2002

ALLEGATION I2000-876 (REPORT I2002-2), NOVEMBER 2002

Department of Veterans Affairs' response as of August 2002[1]

Investigative Highlight . . .

The Veterans Home of California, Yountville, improperly billed Medicare $55,000 for visits that the staff physician did not make.

We investigated and substantiated that the information system used by the hospital at the Veterans Home of California, Yountville (home), for processing charges for services provided to the home's residents contains charges attributed to one doctor for services that the doctor could not have provided.

Finding: The home processed charges for services the doctor could not have provided.

The information system the home uses to bill Medicare, Medi-Cal, and other insurers showed that one doctor saw patients 2,614 times from July 1, 1999, through July 17, 2001, but we concluded that the doctor did not see a patient in 1,792 (69 percent) of those visits. Some of these excess visits in the system were for patients who were not on the doctor's clinic schedule for that day. In 400 other cases, the doctor was not working on the day in question, including weekends, holidays, and days that she was on vacation or sick leave. Furthermore, 148 incorrectly recorded visits were on 50 days on which the doctor worked from home. As further evidence of the information system's lack of credibility, it indicated that the doctor saw patients on every day of 35 consecutive days spanning August and September 1999, 34 consecutive days spanning June and July 2000, and 26 consecutive days spanning May and June 2001. In fact, the billing system indicated that the doctor saw patients on all but three of the 70 days from July 15

[1] Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2003, this is the date of the auditee's latest response.

through September 22, 1999. As of January 22, 2002, the home had billed Medicare $131,000 for 1,488 of these 2,614 patient visits. However, $55,000 was for 887 visits that we concluded the doctor did not make.

Department Action: Pending.

The Department of Veterans Affairs (department) reports that it is actively working to upgrade its billing system and is working with its billing agent to resolve any charges billed and reimbursed incorrectly. Further, the department states that it will ensure that it obtains the signature of the attending physician/technician to maintain proper practices and Medicare compliance.