



Implementation of State Auditor's Recommendations

**Audits Released in January 2002
Through December 2003**

Special Report to

*Assembly Budget Subcommittee #5—
Information Technology/Transportation*

February 2004
Report No. 2004-406 A5

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February 25, 2004

2004-406 A5

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. 5—Information Technology/Transportation. 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
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. 5—Information Technology/Transportation. 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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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 2003¹

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.

ENTERPRISE LICENSING AGREEMENT

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

REPORT NUMBER 2001-128, APRIL 2002

Department of General Services and Department of Finance's responses as of April 2003¹

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.*

continued on next page

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.

RED LIGHT CAMERA PROGRAMS

Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level

REPORT NUMBER 2001-125, JULY 2002

Audit responses as of July 2003 to September 2003¹

Audit Highlights . . .

Red light cameras have contributed to a reduction of accidents; however, our review of seven local governments found weaknesses in the way they are operating their programs that make them vulnerable to legal challenge. Specifically, we found that the local governments:

- Need to more rigorously supervise vendors to maintain control of their programs.*
- All but one would use photographs as evidence in criminal proceedings even though it would appear to conflict with the law governing the program.*
- Generally follow required time intervals for yellow lights.*

Of the local governments we visited, only San Diego and Oxnard have generated significant revenue from their red light camera programs.

Our review of available data shows that red light accident rates decreased between 3 percent and 21 percent after red light cameras were installed by five of the local governments in our sample.

The Joint Legislative Audit Committee (audit committee) asked us to review the implementation, application, and efficacy of red light camera programs statewide. We found that accidents related to motorists running red lights have generally decreased where local governments have employed cameras. However, the seven local governments we reviewed—Fremont, Oxnard, Los Angeles County (Los Angeles), Long Beach, the city of San Diego (San Diego), the city of Sacramento (Sacramento), and the city and county of San Francisco (San Francisco)—need to make operational improvements to maintain effective control of their programs, comply with state law, and avoid legal challenges.

Finding #1: Local governments have been challenged on their control of red light camera programs.

Several local governments have been taken to court by alleged red light violators who claim that the local governments are not operating their red light camera programs as required under the law. Although the law stipulates that only a government agency, in cooperation with a law enforcement agency, can operate a program, it offers no further explanation or definition of what operate means, leaving the term open to interpretation. Because local governments contract out the bulk of services for these programs, private sector vendors inevitably play an important role. However, if municipalities delegate too much responsibility, they run the risk of their program being perceived as vendor controlled. For example, a court found that San Diego failed to satisfy the plain meaning of the word operate and that it had no

¹ Each of the seven auditee's responses were received on the following dates: Los Angeles, Long Beach, San Diego, and Sacramento, July 2003; San Francisco and Fremont, August 2003; and Oxnard, September 2003.

involvement with or supervision over, the ongoing operation of the program and concluded that San Diego exhibited a lack of oversight. San Francisco is in the early stages of defending itself against a similar lawsuit. However, a court ruled in favor of Beverly Hills, which was also the subject of a lawsuit alleging concerns over program operations like those in San Diego.

We recommended that to ensure local governments maintain control and operate their red light camera programs and avoid legal challenge, the Legislature should consider clarifying the law to define the tasks that a local government must perform to operate a red light camera program and the tasks that can be delegated to a vendor.

Legislative Action: None.

No legislative action found.

Finding #2: Local governments must more rigorously supervise vendors to retain program control.

We found that the local governments we visited do not exercise enough oversight of their vendors to avoid the risk of legal challenge over who operates their red light camera programs. Best practices for oversight consists of several elements to monitor and control vendor activities. Such oversight includes strong provisions in local governments' contracts with vendors to protect the confidentiality of motorists' photographs and personal data, making periodic site visits to inspect the vendor's operations for compliance with the law and contract terms, establishing criteria for screening violations, having controls in place to ensure that the vendor only mails properly authorized and approved citations, making decisions as to how long certain confidential data should be retained, and conducting periodic technical inspections of red light camera intersections. However, at the outset of our review, we found that the seven local governments did not exhibit all of the oversight elements we believe are needed to avoid legal challenge. After our inquiries, Long Beach took steps to amend the contract with its vendor to address two elements of oversight that were absent.

To maintain control over their programs and minimize the risk of legal challenges, we recommended that local governments conduct more rigorous oversight of vendors by employing all of the oversight elements we identified.

Local Government Action: Partial corrective action taken.

The seven local governments for which this finding applied reported the following corrective actions:

➡ **Fremont:** Fremont reports that it now performs weekly spot checks of intersections with red light cameras. Further, Fremont completed a vendor site visit in April 2003, and concluded that the vendor maintains its office facility in an organized manner and is conducting business to the city's satisfaction. During this visit, Fremont concluded that the security over data was appropriate and that the vendor was purging Department of Motor Vehicles' records every 90 days. Fremont did not report action on our finding that its contract lacks a specific provision that makes the misuse of the photographs a breach of the contract.

Long Beach: Long Beach reports amending its vendor contract to specifically state that photographs are confidential and to include a provision on when to destroy confidential documents. Further, Long Beach reports implementing a procedure to reconcile citations it has approved against those that the vendor has mailed.

➡ **Los Angeles:** In August 2002, Los Angeles conducted an oversight visit of the vendor and it plans to perform other visits periodically. From this initial oversight visit, Los Angeles concluded that the internal controls are sufficient to maintain the integrity of the evidence and to ensure that only authorized citations are mailed to offending drivers. However, it will reevaluate the need for additional controls over the citation process when it awards a new vendor contract in December 2003. Los Angeles has developed new business rules that require the vendor to comply with all confidentiality provisions of the California Vehicle Code. The business rules also require that information and pictures for unenforced violations be destroyed immediately. The business rules will take effect when the county awards a new contract for red light camera services in December 2003. Recently, Los Angeles has adopted new maintenance procedures to inspect intersections equipped with red light cameras. The new procedures provide that at least once per quarter, or when signal timing is changed, the county's department of public works, red light camera vendor, and the California Highway Patrol will conduct a joint on-site test and certification to ensure that camera settings and calibration are correct.



Oxnard: Oxnard suspended its program in January 2003 and reports that it changed red light camera vendors, with the new vendor beginning to install cameras in September 2003. Under the new vendor contact, Oxnard reports that the vendor must adhere to the confidentiality provisions in law, with any violation constituting a breach of contract with the city. Although the new contract does not require that data and photographs relating to unenforced citations be destroyed immediately, the contract does require that the vendor adhere to the city's policy for records retention and destruction of confidential information. Oxnard also indicates that during an upcoming visit to the vendor's facility, police officers will review the vendor's procedures for compliance with the contract and the practices outlined in our report. Finally, Oxnard believes that the vendor's system allows for a remote confirmation of the calibration of red light cameras. However, Oxnard indicates that it will conduct periodic inspections of intersections to ensure systems are intact and report any problems to the vendor.



Sacramento: Sacramento reports restarting its program in October 2002 as a joint photo enforcement program with the Sacramento County Sheriff's Department (sheriff's department). In September 2003, the city plans to enter an agreement with the sheriff's department, which will essentially allow the county to operate the red light camera program in the city as a part of a countywide enforcement program. The city believes this agreement will standardize and centralize the program so that only one program, with one standard is in effect. The city will have input into camera locations, but the day-to-day operation, maintenance, inspections, and issuance of citations will become the responsibility of the sheriff's department. The city indicates that sheriff's department staff will perform the citation screening, processing, and mailing functions that the vendor previously performed. The vendor will continue to maintain the cameras, develop the film and convert it to digital images, and archive the film. However, Sacramento indicates that all photographs relating to unenforced citations will be retained for three years because the city attorney believes that such retention is necessary to comply with California Government Code, Section 34090, and a city council resolution. Also, although Sacramento County will operate the city's program, the city of Sacramento indicates that it does not intend to review the need for revising the

contract language to specifically protect the confidentiality of data and photographs obtained from the Department of Motor Vehicles until after the current vendor contract expires.

San Diego: San Diego indicates it has restarted the program using the same vendor and that it has made numerous changes that should significantly improve the city's oversight of the vendor. Specifically, the revised vendor contract adds provisions that specify the confidentiality of program data and increase the penalties for contract violations. In addition, the city has developed detailed business rules to guide the vendor's review process. The city's police department will also inspect the vendor's facility each week. These inspections will be documented and will review security and data handling, along with testing a sample of alleged violations for proper handling by the vendor. The city's police department and traffic engineering office will conduct periodic inspections of red light camera intersections to ensure that the system settings and original construction designs have not been altered or tampered with. Further, the city attorney's office developed issuing guidelines for the alleged violations that it deems are prosecutable and the police department has agreed to follow these guidelines. Although not directly related to vendor oversight, the city is now using dual cameras—one showing the front view and one showing the review view—to better show the vehicle approaching the intersection and continuing through it during the red light phase. Finally, San Diego has changed the payment structure to pay the vendor based on a fixed monthly fee for each intersection equipped with red light cameras.

San Francisco: San Francisco reports taking several actions to address our recommendations. It now conducts all team meetings at the vendor's facility and intends to inspect the vendor's facility to ensure that confidential information is being safeguarded. In addition, San Francisco has commenced inspections of red light camera intersections to ensure that camera settings are appropriate and to determine whether the system is functioning properly. Further, in June 2003, San Francisco indicates the police department reconciled authorized citations with those mailed to ensure that only authorized citations were mailed for the period between October 2002 and May 2003. This reconciliation found no errors or inconsistencies. Finally, it has amended the vendor contract to require the vendor to destroy all data related to unenforced violations.

Finding #3: Most local governments believe photographs can be used for other law enforcement purposes.

According to state law, photographs captured by red light cameras are to be used only for enforcing compliance with traffic signals. However, local governments have differing interpretations of the confidentiality of the photographs taken by red light cameras. Six of the seven local governments in our sample acknowledged that they have used or would use the photographs for purposes other than enforcing red light violations, such as investigating unrelated crimes. According to our legal counsel, a literal reading of the statute prohibits use of the photographs for purposes other than to prosecute motorists for running red lights. However, several jurisdictions believe that other laws, as well as the California Constitution, would permit the use of red light photographs as evidence in criminal proceedings. According to our legal counsel, in view of the conflicting interpretation of the law, the courts will ultimately decide whether local governments are violating the red light camera law when they use photographs in criminal investigations. The California Constitution also provides that with a two-thirds vote of its members, the Legislature can specifically exclude certain evidence from criminal proceedings, and according to our legal counsel, this would likely include photographs related to traffic signal enforcement.

Because a potential conflict exists between the confidentiality provision in the Vehicle Code and the California Constitution regarding the admissibility of evidence, we recommended that the Legislature consider clarifying the Vehicle Code to state whether photographs taken by red light cameras can be used for other law enforcement purposes.

Legislative Action: None.

No legislative action found.

Finding #4: Local governments may not have addressed engineering improvements before installing red light cameras.

Although we found that traffic safety was usually the reason for selecting intersections for red light camera enforcement, we could not always verify that local governments addressed engineering solutions before placing red light cameras at intersections. The Federal Highway Administration recommends that before installing a red light camera system, traffic engineers review the engineering aspects of the potential sites to determine

whether the problem of vehicles running red lights could be mitigated by engineering changes or improvements. San Francisco best demonstrated that it met this best practice, while the other local governments we visited conducted their engineering improvements on a more informal and ongoing basis.

We recommended that before installing red light cameras, local governments should first consider whether engineering measures, such as improving signal light visibility or using warning signs to alert motorists of an upcoming traffic signal, would improve traffic safety and be more effective in addressing red light violations.

Local Government Action: Partial corrective action taken.

The six local governments for which this finding applied reported the following corrective actions:



Fremont: Fremont has not reported the action it plans to take on this recommendation.

Long Beach: Long Beach reports that should it decide to expand the program beyond the three-year pilot, it will perform engineering reviews at each location identified for red light enforcement.



Los Angeles: Los Angeles has not reported the action it plans to take on this recommendation.

Oxnard: Oxnard indicates that its traffic engineer has considered all possible options prior to installing red light cameras, including using an all-red interval to clear intersections, adjusting yellow light time intervals, adding new roadway striping, installing light-emitting diodes in signal lamps, and adjusting the posted speed limits. However, as noted in our audit, we could not determine if Oxnard took these steps before installing red light cameras under its original program.



Sacramento: Sacramento has not reported the action it plans to take on this recommendation.

San Diego: San Diego has developed selection criteria for intersections, and it indicates that a detailed list of engineering solutions will be first considered at intersections selected for enforcement before it restarts the red light camera program. Also, intersections selected for enforcement will have a one second all-red interval to allow vehicles in the intersection time to clear.

Finding #5: Some local governments bypassed state-owned intersections with high accident rates.

Caltrans allows red light cameras at state-owned intersections but requires an encroachment permit for construction. The time it takes to obtain an encroachment permit—which grants the local government access to a state right-of-way for construction—was viewed differently among the local governments we visited. Fremont and Long Beach avoided placing red light cameras at state-owned intersections because they anticipated that the Caltrans permitting process would be too cumbersome and would unnecessarily delay the start of their programs. San Diego stated that Caltrans was unwilling to allow red light cameras on state-owned intersections, but the city could not provide evidence of Caltrans’ refusal. Also, Los Angeles did not consider state-owned intersections for its program. By avoiding state-owned intersections, these local governments failed to place cameras at some of the more dangerous intersections within their jurisdictions.

To focus on traffic safety and to avoid overlooking high-accident locations that are state owned when considering where to place red light cameras, we recommended that local governments diligently pursue the required Caltrans permitting process, even though it may cause some delays to their programs.

Local Government Action: Partial corrective action taken.

The four local governments for which this finding applied reported the following corrective actions:

Fremont: Fremont reports that it will be pursuing the installation of red light cameras at state-owned intersections in the near future and that it has begun discussions with Caltrans regarding these installations.

Long Beach: Long Beach reports that should it decide to expand the program beyond the three-year pilot, it will consider placing red light cameras at state-owned intersections.

Los Angeles: Los Angeles has not reported the action it plans to take on this recommendation.

San Diego: The city indicates that it will place red light cameras at state-owned intersections if those intersections meet the selection criteria, regardless of any potential delays.



Finding #6: Not all local governments require vendors to follow municipal permit and engineering standards when installing red light cameras.

Local standards may include issuing the proper permits to perform the work, reviewing engineering drawings and plans for the suitability of the work proposed, and inspecting the finished work for accuracy and adherence to the plans and local construction requirements. Six of the seven local governments we visited required vendors to follow local permit and engineering standards to ensure proper construction and inspection of red light camera systems. However, San Diego chose not to apply its local permitting and engineering standards to red light camera intersections. Specifically, San Diego did not ensure that plans were prepared by a registered civil or electrical engineer, nor was the construction subject to the city's formal plan check, permitting, and inspection procedures.

We recommended that to ensure that intersections are constructed and cameras are installed as planned, local governments should follow their own permit processes by reviewing the as-built plans and inspecting the intersection after construction.

Local Government Action: Corrective action taken.

The one local government for which this finding applied reported the following corrective action:

San Diego: San Diego indicates that it will follow its own permit process. Specifically, it will require that a registered engineer design and submit plans for each red light camera installation for review and approval. Further, a city inspector will inspect the construction of each site before it is placed in operation, and as-built plans will be prepared to illustrate the actual construction of each site.

Finding #7: Caltrans guidance to local governments related to yellow light time intervals could be more specific.

With few exceptions, the local governments we visited complied with a new law requiring that the minimum yellow light time interval at intersections with red light cameras meet the standards established by Caltrans. The law became effective January 1, 2002, and was prompted by the Legislature's concern that yellow light time intervals at such intersections may be shorter than Caltrans' standards. Caltrans' standards use the

speed of the approaching traffic to determine the appropriate time interval for a yellow light. However, the Caltrans traffic manual does not specify how traffic engineers are to determine the speed of the approaching traffic, which can be done in one of two ways: using the posted speed limit or surveying the traffic speed. Therefore, local governments that do not meet Caltrans' standards using both posted speeds and speed survey results run the risk that their yellow light time intervals may be legally challenged.

To avoid the risk of legal challenges, we recommended that local governments petition Caltrans to clarify its traffic manual to explain when local governments should use either posted speeds or the results from speed surveys to establish yellow light time intervals at intersections equipped with red light cameras.

Local Government Action: Partial corrective action taken.

The seven local governments for which this finding applied reported the following corrective actions:

- ➔ **Fremont:** Fremont has not reported the action it plans to take on this recommendation.
- ➔ **Long Beach:** Long Beach indicates that it sent a letter to Caltrans that specifically requested clarification on whether the yellow light time intervals at red light camera intersections should be based on engineering surveys. However, the city had not received a response as of July 2003.
- ➔ **Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.
- ➔ **Oxnard:** Oxnard indicates that its yellow light time intervals comply with accepted standards, but does not indicate whether it petitioned Caltrans to clarify the guidance in the Caltrans traffic manual.
- ➔ **Sacramento:** Sacramento has not reported how it will address this recommendation.
- ➔ **San Diego:** The city indicates that it has increased minimum yellow light time intervals to 3.9 seconds and 3.4 seconds, for a straight through movement and a left turn, respectively. City engineers will also review the approach speeds at red light camera intersections to ensure that the yellow light time intervals meet or exceed Caltrans' standards.

San Francisco: San Francisco reports that it intends to seek confirmation from Caltrans regarding its current practices for yellow light time intervals.

Finding #8: Accounting for program revenues and expenditures is weak.

Although good internal control practices dictate that local governments properly account for the revenues and expenditures of their respective red light camera program, only Fremont did so. Because each local government pays their respective vendor based on the number of red light citations that motorists' pay, it would be prudent for them to properly account for program revenues. Additionally, we found that only Fremont and Long Beach conduct monthly reconciliations of their vendors' invoices with the courts' payment records to ensure that they are paying their vendors the appropriate amount. Also, San Diego, San Francisco, and Oxnard could only provide us with estimates for some of their program costs. Without a more precise method of accounting for program expenditures, these local governments cannot accurately determine the cost-effectiveness of their programs and ensure that local resources are used appropriately.

To allow for better accountability over red light camera programs and to ensure that vendors are paid appropriately, we recommended that local governments improve their methods of tracking revenues and expenditures related to their programs.

Local Government Action: Partial corrective action taken.

The five local governments for which this finding applied reported the following corrective actions:



Los Angeles: Los Angeles has not reported the action it plans to take on this recommendation.

Oxnard: Oxnard indicates that the city's accounting system now allows for the tracking of expenditures related to the red light camera program.

Sacramento: Sacramento indicates that it hopes the partnership with the Sacramento County Sheriff's Department will improve accountability over the program, but it does not indicate specific actions that will occur to implement this recommendation.

San Diego: San Diego's police department and courts have changed their accounting processes to allow for the accurate accounting of red light camera ticket revenues and expenses.

San Francisco: To more accurately calculate expenditures, San Francisco reports that it is looking into setting up an accounting procedure to track police effort on the program.

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.

CALIFORNIA DEPARTMENT OF TRANSPORTATION

Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects

Audit Highlights . . .

Our review of the Department of Transportation's (department) delivery of projects in the State Transportation Improvement Program (STIP) and Traffic Congestion Relief Program (TCRP) revealed that:

- A lack of cash in the State Highway Account will result in the California Transportation Commission (commission) allocating almost \$3 billion less than it had originally planned for STIP projects scheduled in fiscal years 2002-03 and 2003-04.*
- Funding uncertainties associated with the Traffic Congestion Relief Fund (TCRF) have resulted in the commission halting all TCRP allocations, including those to 15 projects that currently need \$147 million in order to continue work.*
- Delayed or cancelled transportation projects will affect the State's aging transportation infrastructure, resulting in deteriorated highways, more traffic congestion, and reduced air quality, as well as higher costs for California residents, in terms of wasted fuel and lost productivity.*

continued on next page

REPORT NUMBER 2002-126, JULY 2003

California Department of Transportation's and the California Transportation Commission's responses as of January 2004

The Joint Legislative Audit Committee asked us to examine the Department of Transportation's (department) delivery of projects in the State Transportation Improvement Program (STIP) and Traffic Congestion Relief Program (TCRP). We found that the department's ability to promptly deliver transportation projects is affected by low cash balances in the State Highway Account (highway account) and Traffic Congestion Relief Fund (TCRF), and consequently, delayed and cancelled transportation projects will negatively affect the State's aging transportation system. The low cash balances in the highway account and TCRF were caused by several factors.

Loans from the highway account and TCRF to the State's General Fund drained cash reserves from these accounts at the same time that the department saw highway account revenues decrease from weight fees. Further, uncertainties related to the former governor's mid-year spending proposal have caused the California Transportation Commission (commission) to halt all allocations to TCRP projects until the budget uncertainties are resolved. Moreover, the department's cash forecast updates continue to be optimistic, and consequently the department could end fiscal year 2003-04 with a negative account balance in the highway account. The department and the commission have alternatives to fund projects in the short-term. However, most of these alternatives also have the potential to decrease the future flexibility of scheduling projects for the STIP and one could be perceived as unfair, so the commission needs to carefully consider and set guidelines for their use.

☑ *Many of the commission's and the department's alternatives to provide needed funding for projects on a short-term basis have the drawback of reducing the department's flexibility to fund future projects, and one potential option available to the commission may be perceived as unfair.*

Finding: The department has insufficient cash to allow it and regional agencies to deliver planned transportation projects in the STIP and TCRP at the levels originally planned.

Lacking sufficient cash in its major transportation funds and accounts, the department and regional transportation planning agencies are unable to deliver many of their planned transportation projects scheduled in the STIP and TCRP. Specific areas our audit identified include:

- Projected cash shortages identified by the department in its December 2002 cash forecast caused the department to temporarily halt allocations to STIP and TCRP projects. While the department's revised March 2003 cash forecast update prompted the commission to resume allocations to STIP (but not TCRP) projects, the department's estimates may be overly optimistic, and could result in the commission making allocations for which the department will lack available funds when later presented with reimbursement requests from implementing agencies.
- Although the commission resumed allocations to STIP projects in April 2003, the allocations are at dramatically lower levels than originally planned. Specifically, 194 projects needing \$103 million in order to move forward with the next phase of project delivery will not receive allocations in fiscal year 2002–03. Moreover, the commission's actual and planned allocations for fiscal years 2002–03 and 2003–04 is almost \$3 billion lower than the amounts originally planned.
- Minimal cash reserves in the TCRF will affect the department's ability to deliver at least 106 projects that require a minimum of \$3.4 billion more in allocations to continue work. Since December 2002, 15 TCRP projects have submitted requests for allocations totaling \$147 million, and work has ceased on 12 of these projects due to lack of spending authority.
- The former governor's May 2003 revision to the governor's budget threatens TCRF funds, calling for the Legislature to delay \$938 million of the transfer of state gasoline sales tax revenues from the General Fund to the Transportation Investment Fund (TIF). Because state law provides for only a set number of annual transfers of specified amounts from the TIF to the TCRF, delays or reductions in amounts transferred to the TIF could result in a permanent annual loss of revenues to the TCRF of up to \$678 million, unless the Legislature acts to obligate the General Fund to repay the TCRF in the future.

- Delayed or cancelled projects will affect the State's aging transportation system, resulting in deteriorated highways, increased traffic congestion, and reduced air quality. Additionally, delays in making improvements means that California residents will pay higher direct costs for wasted fuel and lost productivity. Also, consumers will pay increased indirect costs of the delays in the form of higher prices for goods and services, as well as compounding repair costs for fixing later what the department should fix now.
- The department and commission have alternatives that they could use to fund projects over the short term. However, many of these alternatives have the potential to make future project scheduling inflexible, and one option—pursuing the ability for the commission to rescind TCRP allocations—could be perceived as unfair.

We recommended that, considering the State's fiscal crisis, the Legislature may wish to allow the TIF to transfer the entire \$678 million to the TCRF, and then authorize a loan of the money from the TCRF to the General Fund so that those funds would be repaid to the TCRF and therefore still be available in future years.

Further, we recommended that the department do the following to ensure that it can meet its short-term cash needs:

- Continue its efforts to become more precise in revising its revenue and expenditure estimates and ensure that these revisions are properly supported and presented in cash forecast updates to the commission.
- Continue to cautiously pursue other funding alternatives (GARVEE bonds, SIB loans, direct-cash reimbursement, and replacement projects) to meet short-term project funding needs, and continue to set limits on these alternatives to avoid making future project scheduling inflexible.

Finally, we recommended that should the commission be granted the authority to rescind unspent allocations, it should carefully consider statewide priorities and ensure that all counties are treated fairly before taking such actions.

Department and Commission Action: Partial corrective action taken.

The department states that its cash management team has expanded its cash forecasting activities to include a monthly analysis and projection of construction payments to contractors, which compose a large portion of the department's monthly cash disbursements. The department reports that its cash management team is also in the process of refining monthly projections of expenditures in the toll bridge seismic retrofit account, the TCRF, and the public transportation account to improve its projection of cash in the transportation revolving account. The department further reports that its cash management team has adopted a conservative approach to projecting anticipated federal collections due to uncertainty over passage of the new federal transportation act. Finally, the department reports that aside from monitoring and forecasting cash balances on a daily basis, its cash management team continues to update its internal project tracking database to monitor allocations and expenditures on capital outlay and local assistance projects. The department reports that it presented a quarterly cash update to the commission in September 2003 with recommendations on the amount of cash available for project allocations.

The department agrees with our recommendation that it should continue to cautiously pursue other funding alternatives. The department has implemented the Transportation Finance Bank Revolving Program (SIB loans) and is still developing GARVEE financing.

The commission stated that it has not been granted the authority to rescind unspent allocations, so no action has taken place.

Legislative Action: Unknown.

We are not aware of any action taken by the Legislature to allow the TIF to transfer \$678 million to the TCRF and to authorize the loan of these funds to the General Fund.

CALIFORNIA DEPARTMENT OF TRANSPORTATION

It Manages the State Highway Operation and Protection Program Adequately, but It Can Make Improvements

Audit Highlights . . .

Our review of the California Department of Transportation's (Caltrans) management of its State Highway Operation and Protection Program (SHOPP) found that:

- Most SHOPP projects do not exceed their original funding allocation. Also, although most of the 20 projects we reviewed experienced time delays, the causes for the delays appear reasonable.*
 - Resident engineers did not always maintain complete records of project events. Without these records, Caltrans is vulnerable to contractor claims for more money and cannot accurately assess contractors for liquidated damages.*
 - Caltrans does not evaluate the financial stability of the surety insurers that issue performance and payment bonds to its contractors.*
 - Caltrans lacks comprehensive policies and procedures instructing district staff on how to document and address complaints from the public regarding projects.*
-

REPORT NUMBER 2002-103, AUGUST 2002

California Department of Transportation's response as of August 2003

The Bureau of State Audits examined the California Department of Transportation's (Caltrans) process for managing State Highway Operation and Protection Program projects. Specifically, we were asked to determine whether Caltrans is managing projects to ensure minimal or no cost overruns and time delays, contractors have valid performance bonds from solvent companies, and staff follow Caltrans' public relations policies and procedures.

Finding #1: Some construction engineers do not adhere to Caltrans' policies for managing projects.

Some resident engineers, who manage the project construction costs and administer the contracts, are failing to keep adequate records of days with adverse weather conditions and days that contractors choose not to work on scheduled tasks. Thus, the State lacks necessary records of the causes for project delays and may not be able to assess and collect damages in disputes with contractors about days when they did not work. Also, some resident engineers do not get the required prior approval from the Division of Construction or the district director for construction change orders, which can lead to delays in processing the change orders and to interest charges for late payments to the contractors.

To ensure an adequate defense against contract disputes and to properly assess liquidated damages, Caltrans should ensure that resident engineers and assistant resident engineers maintain complete and accurate daily records of all relevant events occurring on working and nonworking days and that resident engineers complete the weekly statements accurately and in a timely manner. Further, Caltrans should ensure that

its staff obtain prior approval for construction change orders in a timely manner to avoid incurring any unnecessary costs, such as interest for late payments to the contractor, and to ensure that managers agree that proposed changes are necessary. Finally, to aid staff in properly managing construction projects, Caltrans should continue implementing its capital project skill development plan and ensure that staff continue to receive training after the plan expires.

Caltrans' Action: Corrective action taken.

Caltrans is developing an automated construction change order approval tracking system. According to Caltrans staff, this new system will improve the change order and approval process by documenting the required concurrence and prior approval for each construction change order. However, because of limited funding, this new system will not include the tracking of reported working days. Nevertheless, Caltrans has revised certain sections of its construction procedures and specifications manuals. Additionally, it has developed classes on contract administration, including a class specific to the tracking and reporting of working days.

Finding #2: Although somewhat limited by state law, Caltrans can reduce the risk of loss to the state from poor contractor performance.

Caltrans relies on state-required performance and payment bonds issued by a surety insurer (insurer) for loss protection when contractors fail to do the work as specified in the contract. However, although state law permits Caltrans to obtain financial statements from insurers, Caltrans believes it lacks authority to use those statements. Thus, it does not examine the insurer's financial statements, either at the beginning of or during a project, to evaluate its ability to cover possible project losses. However, because state law prevents Caltrans from knowing that the state's Department of Insurance is investigating an insurer that is on its list of approved insurers, it is important that Caltrans does its own checking of insurer's financial statements to reduce its risk of loss.

To ensure that Caltrans can collect on a performance bond if a contractor does not perform, we recommended that the Legislature consider expanding Caltrans' ability to use other financial indicators included within the financial statements and information available from rating companies such as A.M. Best Company and S&P as a basis for determining the

sufficiency of an insurer, before accepting performance bonds. Further, the Legislature should clarify Caltrans' authority to use the information it obtains from financial statements and other financial indicators to object to the sufficiency of an insurer throughout the bond term.

Legislative Action: Unknown.

We are not aware of any legislation that has passed to address this issue.

Finding #3: Caltrans can improve its public relations process to avert negative publicity.

Caltrans can better meet its goal of communicating effectively with the public about construction projects that inconvenience drivers. Caltrans provides guidance to the district offices, but it relies primarily on them to determine when and how to communicate with the public. Unfortunately, most district public information officers do not track the nature and resolution of the complaints they receive, so public dissatisfaction can grow unbeknown to either the public information officers or Caltrans' headquarters.

To ensure that districts handle complaints and inquiries consistently, Caltrans should develop comprehensive public relations policies and procedures that specify the process to use when responding to complaints, the documents that should be maintained, and the method that district offices should use to assess their public relations efforts. Further, Caltrans should monitor the district offices' public relations efforts periodically.

Caltrans' Action: Corrective action taken.

Caltrans has developed and fully implemented a new comprehensive process for addressing project complaints and requests for information, which includes ongoing monitoring of the districts' public affairs function by Caltrans' headquarters.

DEPARTMENT OF TRANSPORTATION

Investigations of Improper Activities by State Employees, February 2003 Through June 2003

ALLEGATION I2002-700 (REPORT I2003-2), SEPTEMBER 2003

Department of Transportation's response as of September 2003

Investigative Highlights . . .

A Caltrans' employee engaged in the following improper governmental activities:

- Misappropriated \$622,776 by requesting purchases and confirming the receipt of products that Caltrans did not receive.***
 - Directed a company to hold state funds outside the State Treasury and act as a fiscal agent without approval.***
-

We investigated and substantiated an allegation that an employee for the Department of Transportation (Caltrans) misappropriated \$622,776 in state money. Our investigation showed that the employee submitted two purchase requests for products the department never received. The employee arranged for the company to hold these funds from these fictitious purchases and act as the State's fiscal agent.

Finding: An employee misappropriated state funds.

The employee misappropriated \$622,776 by submitting two purchase requests. After submitting the purchase requests, the employee directed the company to cancel delivery of the items and hold the payments in a company maintained account. In addition to initiating the purchase, the employee also verified the receipt of the products even though the company never sent these items. According to the employee, she directed the company to hold these funds outside the State Treasury and act as a fiscal agent to correct clerical errors and purchase training and information technology (IT) products for her unit.

In addition, poor management contributed to the misappropriation of funds. The employee's manager did not verify the receipt of the products on the fictitious purchases. The employee's unit gave the employee the responsibility and authority to request products, ensure their receipt, and monitor the funds used, which created the opportunity to misappropriate the funds.

Although Caltrans cannot completely account for the misappropriated funds, it paid unauthorized taxes and fees to the company. The balances that the employee and the company

maintained did not reconcile partly because the company commingled state funds with its own. However, the State did pay unauthorized taxes and fees. The company retained \$44,191, which represented sales taxes associated with the false purchase requests, and charged the State \$68,505 to maintain the account. Although the company likely earned interest during the two-year period it retained these funds, it did not allocate this interest to the State. Nevertheless, the company remitted \$75,698 to Caltrans, an amount it considered to be the balance the State paid for undelivered products.

Caltrans' Action: Partial corrective action taken.

Caltrans reported that it reinstated its prior policy of having all IT purchases shipped to, received, accepted, inventoried, and tagged by its Shipping and Receiving and Property Control units. Further, Caltrans reported that it initiated a practice of utilizing the Department of General Services' Technology and Acquisitions Support Branch for all IT procurements over \$500,000. Caltrans transferred the employee to another branch where her duties do not include procurement-related duties and will take appropriate disciplinary action against the employee upon completion of its review of case documentation. Caltrans added that it has contacted the appropriate law enforcement agencies to investigate any criminal implications or activity relating to the misappropriation. Caltrans also reported that it will make appropriate changes to its procedures after completing a review of its internal controls related to approval authorizations and documentation.